

differential. Hence, Option 4 performs worse than the current system.

5. *Facilitate orderly marketing with coordinated system of prices.* Another problem with Option 4 is that resulting Class I differentials are not coordinated across wide areas and thus do not facilitate orderly marketing. Milk, both packaged and bulk, moves long distances. Class I differentials should encourage milk to move in directions indicated by underlying economics, essentially from areas that have relative surpluses of milk to areas that are relatively deficit. Option 4 performs worse than the current system in this area.

6. *Recognize handler equity with regard to raw product costs.* Processor equity suffers under Option 4 because Class I over-order charges would need to increase in many areas. While it may be desirable for the market to set the final Class I price charged to bottlers, when a large portion of this price occurs outside of regulation, Federal orders cannot assure a reasonable degree of handler equity concerning prices paid for Class I milk. Additionally, the net effect of the Class I price paid by handlers less the transportation credits received would likely create inequity among handlers.

Option 4 was evaluated against the administrative criteria as follows:

1. *Minimize regulatory burden.*

Option 4 would increase the regulatory burden on handlers as compared to the present system. Additional reporting on sources of milk and transportation costs would be required. Fluid handlers would be required to report, and Market Administrators to verify, hauling cost information on each load of bulk milk received. This additional regulatory requirement may also result in an increase in administrative assessments to handle the additional record verifications.

2. *Minimize impact on small business.*

It is likely that small handlers might be disadvantaged by this option. With demand-based differentials, a substantial part of the Class I value needed to attract adequate milk supplies would likely come from over-order payments. Federal order Class I prices are mandatory and should affect handlers in an area equally. Over-order pricing is not mandatory and may or may not affect different handlers equally. The potential exists under Option 4 for large handlers to have an advantage over small handlers in competing for milk for Class I purposes because they will be able to outbid smaller handlers for a supply of milk.

3. *Provide long-term viability.* Option 4 would involve Class I differentials that

could change over time as milk supply/demand conditions change. As such, the system could remain viable for a long period of time if the problems outlined above did not jeopardize the viability of this proposal. There is a certain attractiveness to a system which is self-adjusting. The difficulty is in deriving a system where the self-adjusting feature stays current over time.

This proposal could have a significant impact on various sectors of the dairy industry. The impact would likely vary by region, with large impacts on regions where Class I differentials would change significantly and lesser impacts in regions with small changes in Class I differentials. The impacts by region are discussed below:

Midwest. Class I differentials in the Midwest would be similar to current differentials under Option 4. In addition, the vast majority of milk produced in the Midwest is used for manufactured products, not for Class I. As such, the impact on producers and processors would be expected to be relatively small. Producer groups and cooperatives in this area fully recognize that, due to low Class I utilization in this area, changes in Class I differentials will have relatively less impact here than in other areas which have higher rates of Class I utilization.

Northeast. In the Northeast, Class I differentials would be substantially reduced from current levels under Option 4. For example, the Class I differential in New York City would be \$1.34 less than the current differential, while the Class I differential in Baltimore would be \$1.80 less than under the current system. Producer organizations in the Northeast have historically had a difficult time enforcing Class I over-order charges significantly above Federal order minimums. Cooperatives have depended heavily upon Federal order minimums, and more recently upon the Northeast Dairy Compact, to try to maintain revenues from Class I sales.

Processors in this area have historically had significant marketing power over cooperatives. Substantial drops in Class I differentials would likely increase processor marketing power and prevent cooperatives from establishing over-order prices that would reflect the full Class I value thus, dairy farmers would see a decline in their revenue.

Producer income levels in this area would be expected to decrease with a resulting decline in producer numbers, milk production and, eventually, manufacturing capacity. The decline in manufacturing capacity, over time, would likely be the most significant

impact on the processing side of the industry in the Northeast.

Southeast. In the Southeast, Class I differentials would be substantially reduced from current levels under Option 4 in many areas. For example, the Class I differential in Atlanta would be set at \$0.70 less than the current system, while the Class I differential in New Orleans would be \$2.37 less than under the current system. It is unclear if over-order charges in most parts of the Southeast could be increased enough to compensate for the drop in Federal order Class I differentials. Thus, producer income and milk production would be expected to decrease in total in this area. Much of this area is deficit of milk production and, at certain times of the year, for fluid needs. Dropping the Class I differentials substantially would likely increase this deficit and make it increasingly difficult to meet the AMAA requirements for meeting the needs of the fluid market.

Southwest. In the Southwest, Class I differentials would be substantially reduced from current levels under Option 4. For example, the Class I differential in Dallas would be set at \$1.76 less than the current system, while the Class I differential in Denver would be \$1.54 less than under the current system. It is unlikely that over-order charges in most parts of the Southwest could be increased enough to compensate for the drop in Federal order Class I differentials. Thus, producer income and milk production would be expected to decrease in total in this area. The impacts would likely vary within this region as lower production costs in West Texas and New Mexico could offset the drop in Class I revenues, but higher production cost areas (e.g., East Texas) would likely show substantial drops in milk production.

Pacific Northwest. In the Pacific Northwest, Class I differentials would be reduced from current levels under Option 4 in many areas. For example, the Class I differential in Portland, Oregon, would be set at \$0.77 less than the current system, while the Class I differential in Seattle would be \$0.59 less than under the current system. It is unlikely that over-order charges in most parts of the Pacific Northwest could be increased enough to compensate fully for the drop in Federal order Class I differentials.

This proposal would, all else being equal, result in lower blend prices to producers in most parts of the country. It is expected that mailbox prices to producers would also decline in most regions. The vast majority of producers pooled on Federal orders are considered

as small businesses. Thus, this proposal would have a negative impact on small business producers through a loss of income.

In addition, it is expected that in regions that are deficit of milk for some or all uses, an increased reliance on over-order prices would result from this proposal. Experience has shown that in an unregulated or partially-regulated environment, such as where substantial over-order premiums are paid, large producers often have greater leverage with milk buyers than small producers. This advantage can take many forms including volume premiums, lower hauling rates, and the ability to negotiate individually with handlers in a manner difficult for small producers.

This proposal could likely increase the regulatory burden on handlers that are small businesses. Maintenance of transportation credit records and increased verification that may be required could burden small business handlers. Moreover, setting Class I differentials at levels significantly below the full economic value of Class I milk at location has the impact of deregulating the effective price of Class I milk. As such, small handlers would be competing for milk supplies with large handlers with no assurance of similar prices. Equity among handlers is one of the benefits of the Federal order system. By setting Class I differentials at a level well under the full economic value, some of the handler equity is lost. It is expected that such a scenario would provide a greater burden on small business handlers than on large business handlers.

It is difficult to quantify the impact to consumers under this option. Federal order Class I differentials around the country would likely be lower than under the current system at many locations. Increased over-order charges may make up part of the difference, at least at locations with strong supply organization cooperation. It is expected that the overall impact on consumer prices would be slight.

Option 4 presents certain attractive provisions when viewed as a theoretical model for establishing Class I differentials. While it is intellectually appealing to have frequently adjusting Class I differentials, this type of proposal contains significant challenges to actual implementation. A substantial set of calculations would be necessary, together with strong assumptions regarding transportation costs, to determine Class I differentials under this option. The proponents of Option 4 utilized the USDSS model to estimate their Class I differentials. Proponents were unclear as to the specific points for

calculating transportation. Arguably, the distance from each farm to each distributing plant that the farm supplies, as well as the distance from each supply plant or reserve processing plant to each distributing plant, would need to be determined.

Option 4 is not a pure pricing concept, but an allocation of costs. It proposes "Class I differentials" at location, thereby intimating value of milk at location. However, such a surface conclusion is erroneous when it becomes operational. It essentially becomes a flat price proposal insofar as milk value (price) is concerned.

This option in essence proposes that regulators intervene in the contractual relationships among producers, processors and haulers. Rather than creating a system whereby producers are paid a price for a product (valued to include all costs of producing and delivering the product to market), this proposal seeks to administratively isolate transportation cost and reimburse that cost at a fixed rate. To attempt to intervene in marketplace relationships in this way, particularly under the umbrella of price, does not seem appropriate.

As a result of this analysis, it is concluded that Option 4 would merely result in a greater degree of regulation with less money returned to producers. Thus, based on the issues discussed, Option 4 is not further considered as a replacement for the Class I price structure.

Based on the qualitative analysis, three pricing options were selected for further quantitative analysis. The Department determined that the three options selected represented a broad spectrum of possible Class I price structures. These three options are Option 1A, Option 1B, and Option 5.

To further analyze these options, beyond the evaluation criteria and basic quantitative analyses, a multi-regional model of the U.S. dairy sector, developed by the Economic Research Service of USDA, was used to generate both the "model baseline" results and analysis of the three pricing options. The model has been specified to generate a long-term outlook that is consistent with the Department's official baseline forecast for the dairy sector. The model baseline serves as a benchmark for comparing price and income changes of an option. For example, price impacts are reported as differences from the baseline for each of six years (1999–2004) and from the 6-year average. A more detailed explanation of the model and the

economic impact results are included in the initial regulatory impact analysis.²⁴

Based on this analysis, Option 5 was eliminated from further consideration as a viable replacement for the Class I price structure. Although Option 5 appeared appealing in the qualitative analysis, the quantitative analysis revealed that Option 5 would create an unsustainable situation, based on the degree of increased price levels, given the dynamics of milk marketing. The analysis of Option 5 follows:

Option 5: Decoupled Baseline Class I Price with Adjustors. Option 5, as proposed by Mid-America Dairymen, Inc. (Mid-Am), is a price structure that would decouple Class I prices from the volatility of the commodity markets. Since the Class I price would be decoupled from the basic formula price, the proponents suggest that 1996 average Class I prices become the base, with adjustments made utilizing changes in fluid use rates and short term costs of production (i.e., feed costs). Thus, for Class I purposes the BFP would be floored at \$13.63 per hundredweight, the 1996 annual average BFP. This price level would be used to establish Class I prices using current differentials.

A supply/demand adjustor would be used to change prices in each of the orders to reflect long-term trends. Proponents suggest using a 12-month rolling average Class I utilization, rounded to the nearest full percentage. Class I prices would be adjusted by \$0.12 per hundredweight for each 2 percent change in the rolling average utilization. For example, a Class I utilization change from 44 percent to 46 percent in a market would result in a \$0.12 per hundredweight gain in the market's Class I differential. Once the utilization level changes, the new utilization rate becomes the base for future changes. Thus, if a market falls from 44 percent to 42 percent, the new base for comparing a 2-percentage point change up or down is 42 percent.

In addition to the supply/demand adjustor, a cost of production indicator would be developed whereby Class I prices would be increased in a timely manner when input costs to dairy farmers are increasing. One such economic indicator might be feed costs.

The table below illustrates the initial Class I differentials under the proposed consolidated orders. These differentials are not location-specific within the applicable orders. For purposes of this

²⁴ Copies of this analysis can be obtained from Dairy Programs at (202) 720-4392, any Market Administrator office, or via the Internet at <http://www.ams.usda.gov/dairy/>.

analysis and to provide a basis for comparison within the proposed consolidated orders, a weighted average Class I differential for each order has been calculated for each order based on October 1995 data. This weighted average differential is computed by

multiplying the percentage of Class I milk in each of the current orders that comprise the consolidated order by the applicable current order differential and adding the resulting amounts. The weighted average differential is not location-specific for the consolidated

orders. Initially the differentials will be the same. However, as Option 5 impacts production and utilization, and when an economic indicator (such as feed costs) is calculated, the differentials will vary.

TABLE 5.—INITIAL CLASS I DIFFERENTIALS IN PROPOSED ORDERS BASED ON 1995 DATA UNDER OPTION 5: DECOUPLED BASELINE CLASS I PRICE WITH ADJUSTORS

Proposed order ¹	Weighted average differential (\$/cwt) ²	Initial differential (\$/cwt)	Change in differential (\$/cwt)
Northeast	3.14	3.14	0.00
Appalachian	2.79	2.79	0.00
Southeast	3.04	3.08	0.00
Florida	3.89	3.89	0.00
Mideast	1.91	1.92	0.00
Central	2.52	2.41	0.00
Up Midwest	1.32	1.41	0.00
Southwest	3.01	3.01	0.00
AZ-Las Vegas	2.46	2.46	0.00
Western	1.84	1.84	0.00
Pacific NW	1.90	1.90	0.00

¹ Based on the 11 proposed orders contained in this proposed rule.

² Weighted average differential for the consolidated order is computed by summing the product of the percentage of Class I milk for each current order multiplied by the applicable current order differential.

Analysis Based on the Evaluation Criteria

Option 5 performs about equal to the current system in five of the nine evaluation criteria. The option performs poorer than the current system in the other four evaluation criteria.

Option 5 was evaluated against the objective criteria as follows:

1. Ensure an adequate supply of milk for fluid use. With a high baseline and a supply/demand adjustor (and possibly an economic adjustor), Option 5 performs on a national level about the same as the current system, particularly in the short term.

2. Recognize quality (Grade A) value of milk. As with all of the options, Option 5 does recognize the quality (Grade A) value of milk. Use of the current differentials to achieve the Class I price recognizes this value.

3. Provide appropriate market signals. Option 5 decouples the Class I price from the basic formula price and thus the commodity market. A rolling average Class I utilization is proposed as the appropriate measure of supply/demand. A rolling average further delays any market signal sent by Class I utilization. Moreover, the option proposes to change the Class I price only when the rolling average utilization changes by 2 percent or more. Option 5 essentially freezes prices, albeit, at a historically high level. In fact, it appears to suggest that the

market signal for fluid use milk should be fairly static.

Proponents have suggested an economic indicator (feed cost adjustor) of some kind be used to adjust prices short term. While it is likely true that inclusion of such an index would mute declines in milk prices when feed costs are rising, market driven declines in milk prices also could be accelerated if feed costs were declining at the same time. Thus, even combined with a supply/demand adjustor, this option would not perform as well in providing appropriate market signals as the current system.

4. Recognize value of milk at location. Option 5 would include the current system of differentials. Therefore, this option does recognize the value of milk at location and performs as well as the current system.

5. Facilitate orderly marketing with coordinated system of Class I prices. As long as no adjustment is made to the baseline prices, alignment would be maintained fairly well. However, Option 5 has no provision to align prices when price changes occur. A possible \$0.24 price spread between two markets within one month could exist. Moreover, misaligned prices could create disorderly conditions as industry participants between and among the markets seek other measures to regain alignment in prices. Hence, Option 5 performs worse than the current system because it would lead to disorderly marketing conditions.

6. Recognize handler equity with regard to raw product costs. As long as no adjustment is made to the baseline prices, handler equity would be maintained fairly well. Option 5 does ignore the relationship of handlers in adjacent markets. If prices are increased or decreased in a market, the handler regulated in an adjacent market may be affected by the misalignment of prices. Misaligned prices could create disorderly conditions as industry participants between and among the markets seek other measures to regain alignment in prices.

Option 5 was evaluated against the administrative criteria as follows:

1. Minimize regulatory burden. Option 5 is not likely to increase the regulatory burden on handlers when compared to the current system. The addition of adjustors would create some additional burden on regulators; however, this would not be substantial.

2. Minimize impact on small business. Option 5 performs worse than the current system with regards to small businesses. It is likely that the individual market supply/demand adjustor will create some disruption in inter-market price alignment over time. Such a system may result in the need for over-order charges in some markets. Small handlers would likely be affected in their ability to compete with large handlers for a raw milk supply.

3. Provide long-term viability. The use of a historic baseline price as the major portion of a price fails to factor into the

competitive price of milk any of the influences of the national milk market. It ignores advances in technology and increased efficiencies. In addition, it fails to recognize trends in the overall economy such as inflation and interest rates. Thus, this option does not provide long-term viability.

Upon implementation, all Class I differentials would be equal to current differentials. With the baseline utilizations established at 1996 levels, producers would experience Class I price increases since 1996 was a record high year for milk prices. Every existing order area would see increases in Class I prices of \$0.85 per hundredweight above the baseline in the initial year. However, even with this increase, some producers may see declines in blend prices as a result of the proposed consolidation of orders contained in this proposed rule.

Initially, Option 5 would not have a significant impact on the competitiveness of small businesses, producers, or processors because prices would remain relatively the same. However, as the supply/demand adjuster modifies the differentials based on changes in Class I utilization, price alignment between markets will become an issue that would affect a small business' ability to compete. This option would increase the retail cost of fluid milk in the initial year or two but would lower the cost of manufactured dairy products.

This option appears attractive on the surface since higher Class I prices will help most producers. If utilization and feed costs do not move abruptly, or if the feed cost formula is designed in such a way as to moderate any abrupt price movements, then variability in Class I prices would be moderated. However, it seems likely that milk prices will be increasing or decreasing in the same direction as feed prices (i.e., higher feed prices means less milk production thus higher milk prices, lower feed prices means more milk production thus lower milk prices.)

Another attractive feature of this option is that the use of a feed cost adjuster would adhere to requirements of the AMAA that the Department consider such costs and other economic conditions in the establishment of prices. In addition, an automatic utilization adjuster could reduce the need to have hearings to change Class I differentials if changes in production or consumption in an area make the existing differentials inappropriate.

Although attractive on the surface, further analyses of Option 5 reveals significant problems. First, analysis completed by the multi-regional ERS

model indicates that the increase in prices experienced will not be sustainable. The results of the model analysis indicate that the higher floored Class I prices will impact the all-milk price, and after 3 years, producers will begin seeing a decrease in the revenue initially generated by Option 5. This will occur because the higher Class I prices will stimulate milk production, which will then lead to lower manufacturing prices. Because it is the blend price that is paid to producers, the increase in the Class I prices will not be enough to offset the decrease in prices of the other classes of use and the changes in utilization which will affect the differential level. Further details of the model results are included in the economic impact analysis published in conjunction with this proposed rule.

Next, Option 5 may cause disorderly marketing with the introduction of inter-market disparities based on temporary changes in use. Producers in high Class I markets would benefit at the expense of producers in low Class I markets. In addition, flooring the Class I price will shift volatility to milk prices in manufacturing markets. If the feed cost adjuster only affects Class I prices, high utilization markets will gain relative to producers in lower Class I use markets, who would also bear the higher feed costs.

Finally, Option 5 uses current differentials to establish Class I prices. Although, the 1990 hearing resulted in changes to many of the current Class I differentials, many of the current differentials are similar to those that were prescribed in the 1985 Farm Bill. Thus, arguments could be made that using the current 1996 Class I differentials as a base for a new Class I pricing surface runs counter to the 1996 Farm Bill mandate that the new Class I differentials cannot be based on the differentials described in the 1985 Farm Bill.

As discussed, Option 5 will create several problems if implemented as a Class I price structure. Furthermore, questions arise as to whether or not Option 5 is legal as it may violate the mandates of the 1996 Farm Bill. Finally, proponents may no longer be actively supporting this option as a viable replacement for the Class I price structure. Thus, based on this qualitative and quantitative analysis, Option 5 is eliminated from further consideration as a Class I price structure replacement.

With the elimination of Option 5, only two Class I price structure options remain as possible replacements for the current Class I price structure, Option 1A and Option 1B. These two options

present national price structures developed utilizing the USDSS model. The options vary in their reliance and application of the USDSS model but both are based on economic principles contained within the model. Both price structures have been evaluated qualitatively against the evaluation criteria and quantitatively utilizing the multi-regional ERS model discussed earlier. In addition to analysis conducted by the multi-regional ERS model, a static Federal order pool analysis has been conducted for Option 1A and Option 1B to provide an estimate of how the options would have impacted producer prices during October 1996. The results of the pool analyses will be addressed in a discussion comparing the two price structures.

It should be noted that both Option 1A and Option 1B may require additional fine-tuning of the Class I differentials and adjustments for location when actual implementation of the selected price structure occurs within the Federal order program. However, this fine-tuning would only slightly alter the impacts of either option. The price surfaces presented provide a reasonable indication of the level of Class I differentials that may result under each price surface.

Option 1A: Location-Specific Differentials. Option 1A would establish a nationally coordinated system of location-specific Class I price differentials reflecting the relative economic value of milk by location. An important feature of the option is that it would also include location adjustments that geographically align minimum Class I milk prices paid by fluid milk processors nationwide regardless of defined milk marketing area boundaries or order pooling provisions. It is based on the economic efficiency rationale presented in Cornell University research on the U.S. dairy sector.²⁵ A basic premise of Option 1A, confirmed by the Cornell research, is that the value of milk varies according to location across the United States. Option 1A combines these concepts of spatial price value and relative price relationships together with marketing data and expert knowledge of local conditions and

²⁵ Pratt, James E., Phillip M. Bishop, Eric M. Erba, Andrew M. Novakovic, and Mark W. Stephenson, "A Description of the Methods and Data Employed in the U.S. Dairy Sector Simulator, Version 97.3," Research Bulletin 97-09, A Publication of the Cornell Program on Dairy Markets and Policy, Department of Agricultural, Resource, and Managerial Economics, Cornell University, July 1997.

marketing practices to develop a national Class I price structure.

Compared to other Class I price structure options which have been proposed by interested parties and/or are under consideration by the Department, this option reflects the current Class I pricing surface more than the others. Although similar to the current Class I price surface, there are distinct differences.

Under Option 1A, Class I differentials are lowest in geographical areas evidencing the largest supplies of milk relative to local/regional fluid milk needs. The differentials become progressively higher as they move from these areas to markets with less production relative to demand for fluid milk. Nine differential zones provide the basis for establishing the price structure. These zones were established based on results of the USDSS model, knowledge of current supply and demand conditions, and recognition of other marketing conditions such as fluid versus manufacturing markets, urban versus rural areas, and surplus versus deficit markets.

Class I differentials under this option range from a low of \$1.60 per hundredweight in the base zones of the Upper Midwest, Southwest, and West, where there are abundant supplies of milk in excess of fluid milk use, to a high of \$4.30 per hundredweight in Florida, where there are deficit supplies of milk for fluid use, thus reflecting the location value of milk for fluid use. The nine zones, differential ranges, and basis for establishing the Class I differential levels are as follows:

Zone 1. The suggested differentials within Zone 1 range from \$1.60 to \$1.90 per hundredweight. Geographically this zone is very large and encompasses the entire Northwestern United States. It consists of Washington, Oregon, Montana, Idaho, Northern and Central California, Northern and Western Nevada, Northern and Western Wyoming, and Northern Utah.

The area defined includes the top milk production state as well as two more of the top ten milk producing states. Milk production in this region has grown and continues to do so. Milk production in this zone tends to be concentrated in three areas: Western Washington and Oregon, the Southern Valley of Idaho and Northern Utah, and the Central Valley of California. Due to the numerous mountain ranges it encompasses, much of the zone is rural and sparsely populated. The exception is the heavily populated Western Coastal areas.

Class I utilization for this zone is fairly low and a significant amount of

manufacturing is required to balance the markets. Manufacturing facilities are readily accessible in the milk producing areas. Zone 1 has excess supplies of milk, and therefore, could be an additional source of milk for other regions of the country.

It is expected that Zone 1 will continue to maintain adequate supplies of milk for the Northwestern United States. The supplies of milk are within relatively short distances of plants thus not requiring significant location adjustments within the zone.

Zone 2. The suggested differentials within Zone 2 would range from \$1.60 to \$2.65 per hundredweight. Zone 2 is a large region encompassing the Southwestern United States. It consists of Arizona, New Mexico, Colorado, Southern California, Southeastern Nevada, Southern Utah, Southeastern Wyoming, Southwestern Kansas, West Texas, and the Panhandle of Oklahoma.

The area defined includes portions of two of the top ten states in milk production as well as two more in the top twenty. Milk production in this zone has grown significantly over the last several years, but has recently slowed. Milk production in this zone tends to be concentrated in five areas: the Southern Valley of California, the Phoenix area of Arizona, North Central Colorado, the El Paso area of Texas and New Mexico, and the Roswell area of New Mexico. Much of this region is rural and sparsely populated due to the mountainous and arid terrain. The only heavily populated area is the Coastal region of Southern California. For the rest of the zone, populated areas tend to congregate around the capital cities of the Southwestern states.

Class I utilization for this area is slightly greater than the average for the United States. Manufacturing is needed to balance these markets; however, only a limited number of plants are located within the zone. Milk supplies in the zone are ample for Class I demand, but not always within a short distance of these needs. Distant manufacturing facilities are used at times for balancing. Other regions of the country have relied on this zone as a supplemental supply source. However, a slight change in the manufacturing capacity of this zone could change milk availability for other regions. Some location adjustments are needed for alignment purposes with the more deficit markets to the East.

Zone 3. The suggested differentials within Zone 3 would range from \$1.60 to \$1.80 per hundredweight. Geographically this zone encompasses the Upper Midwest region including the states of Minnesota, Wisconsin, Iowa, and North Dakota, the Michigan Upper

Peninsula, and parts of South Dakota, Nebraska, Missouri, and Illinois.

This zone includes two of the nation's top five milk producing states, Wisconsin and Minnesota, as well as the substantial milk supplies available in parts of surrounding states. The vast majority of milk in Zone 3 is used for manufacturing purposes throughout the year. In addition, as was readily apparent in the fall of 1996, this area provides large quantities of milk to distant markets at times of shortages for fluid purposes in those markets. The \$1.60 differential equates to the Class I differential in base zones to the Southwest and West that also use substantial quantities of milk for manufacturing purposes throughout the year. The 20-cent range provides some flexibility in setting Class I differentials that align with neighboring zones and in encouraging shipments to high Class I demand areas within the zone.

In addition, a Class I differential of \$1.60 to \$1.80 in this zone will provide a greater incentive for manufacturing organizations in this zone to pool milk. Historically, there have been small pool draws (that at times fluctuate between positive and negative) and negative location adjustments. Generally, over-order charges have been required to ensure adequate milk supplies for fluid purposes. Hence, the additional revenue generated in this region will be used to move some of these over-order charges under the Federal order program in the form of transportation credits. As a result, the \$1.60 to \$1.80 Class I differentials will help to establish higher pool draws and enable more market participants to share in the benefits of servicing the fluid market.

For a number of years, prevailing over-order charges in this zone have resulted in effective Class I prices to fluid milk processors that are well above the Federal order minimums herein proposed. Thus, Class I processors should see no increase in their milk procurement costs, but would likely only see a partial redistribution of their costs from over-order charges to Federal order obligations.

Zone 4. The suggested differentials within Zone 4 would range from \$2.65 to \$3.65 per hundredweight. Geographically, this zone is fairly small and primarily covers two states: Louisiana, west of the Mississippi River, and central and east Texas.

The zone defined has a significant amount of milk production and population. Texas ranks as the sixth largest milk-producing state and is the second most populated. Milk production in this zone is concentrated in two areas: East of Dallas and

Southwest of Dallas. Population centers are spread throughout the region with significant population along the Gulf Coast of Texas and Louisiana.

Class I utilization is moderately high and the zone has primarily been considered a fluid market. Much of the manufacturing in this zone is based on weekly and seasonal balancing. Excesses tend to be limited to Spring flush periods while Fall usually brings a deficit. Local demand along the Southern Coastal area requires supplies to travel significant distances to meet fluid demands. Seasonal deficits are handled by various other regions of the country.

The differential range proposed is needed to move milk supplies south and east to align with Southeastern deficit markets. Zone 4 may depend increasingly on milk suppliers from other regions of the country. However, the range of differentials suggested should be adequate to maintain a local milk supply.

Zone 5. The suggested differentials within Zone 5 range from \$2.00 to \$3.00 per hundredweight. Geographically, this zone ranges from Maine in the east to Oklahoma and southeastern Kansas in the west. The zone encompasses parts of the milk-producing areas of New York and Pennsylvania and the more dispersed production in the eastern mountains, the Ohio and mid-Mississippi River basins, and reaches into the southwestern United States. This zone is populated with a mix of rural areas plus a number of medium-sized metropolitan areas. The suggested price flow is generally from north to south and from west to east within this long narrow zone.

The range of differentials from \$2.00 to \$3.00 provides a transition from the surplus areas of the North and West to the deficit areas of the Southeast.

Zone 6. The suggested differentials within Zone 6 range from \$3.00 to \$3.75 per hundredweight. Geographically this zone encompasses all of South Carolina, most of the states of North Carolina,

Georgia, Alabama, Mississippi, and parts of Louisiana and Florida.

This is a zone of deficient milk supplies and declining milk production. This zone contains many rural areas with a heavy concentration of population along a corridor from Raleigh, North Carolina, to Atlanta, Georgia. It is a zone which currently has a high Class I utilization and little access to manufacturing milk facilities.

The differentials increase moving toward the south and southeastern parts of Zone 6. The Atlantic and Gulf Coast areas are also in the higher end of the range because these areas are not heavy milk production areas. Zone 6 may depend increasingly on milk supplies from outside the areas; however, the differential range proposed should be adequate to provide a milk supply to meet the fluid demand in the zone.

Zone 7. The proposed differentials within Zone 7 range from \$3.75 to \$4.30 per hundredweight. Geographically it encompasses all of the lower two-thirds of Florida. Annual milk production in the zone does not meet Class I needs or provide an adequate volume. Milk supplies needed to meet the demand in this zone are procured from distant areas of the country. The price increases as the surface moves from north to south allowing milk to move to the deficient areas of Florida. Population density relative to viable milk-producing areas within this zone is creating increasing land-use pressure. The differentials proposed should be adequate to attract necessary milk supplies to meet the fluid demand.

Zone 8. The suggested differentials within Zone 8 range from \$1.80 to \$2.00. The zone covers parts of 12 states ranging from the southwest corner of South Dakota to the western corner of New York. This zone, together with parts of Zone 5, form an intermediate area between Zone 3, where milk is used primarily for manufacturing purposes, and Zones 4, 6, 7, and 9, where milk is used primarily for Class I purposes.

The price range in this zone would provide for alignment with markets to the north, south, and east, and set differentials at a level that would recognize the supply/demand conditions in this area. Alignment of Zone 8 with neighboring zones, particularly to the east and south, minimizes disruptions to the existing competitive relationships for Class I handlers in these areas.

Zone 9. The proposed differentials in Zone 9 range from \$3.00 to \$3.25 per hundredweight. Geographically Zone 9 encompasses the north Atlantic coastal area of the United States. The zone includes the major cities of Boston, New York, Philadelphia, Baltimore, and Washington, D.C. The differentials in Zone 9 allow for recognition of the need to move milk to major metropolitan areas on the Atlantic coast. The 25-cent range will provide the pool structure to compensate for individual locations within a narrow geographic area.

Zone 9 represents a major consumption area. The zone will need to look to the milk production areas north and west of the cities for milk supplies. The differentials proposed for this zone should allow the area to maintain adequate milk supplies relative to fluid demand.

This price variance in Class I differentials across the country presented in Option 1A is less than the range in relative values for milk (i.e., shadow prices) determined through the USDSS model and lower than the difference in the current price structure. The range of differentials developed by the USDSS model is \$3.60 based on October 1995 data, typically a more deficit month, and \$3.40 based on May 1995 data, typically a more surplus month. The price spread for Option 1A is \$2.70. The ranges discussed above are set forth in Map 1. The differentials adjusted for location established for each county are set forth in Maps 2A, 2B, and 2C. Table 6 sets forth examples of differentials adjusted for location at selected cities.

TABLE 6.—COMPARATIVE CLASS I DIFFERENTIALS ADJUSTED FOR LOCATION AT SELECTED CITIES UNDER OPTION 1A—LOCATION-SPECIFIC DIFFERENTIALS

City	Class I differential		Difference
	Current	Option 1A	
	Dollars per hundredweight		
New York City, NY	3.14	3.15	.01
Charlotte, NC	3.08	3.10	.02
Atlanta, GA	3.08	3.10	.02
Tampa, FL	3.88	4.00	.12
Cleveland, OH	2.00	2.00	.00
Kansas City, MO	1.92	2.00	.08
Minneapolis, MN	1.20	1.70	.50

TABLE 6.—COMPARATIVE CLASS I DIFFERENTIALS ADJUSTED FOR LOCATION AT SELECTED CITIES UNDER OPTION 1A—LOCATION-SPECIFIC DIFFERENTIALS—Continued

City	Class I differential		Difference
	Current	Option 1A	
Chicago, IL	1.40	1.80	.40
Dallas, TX	3.16	3.00	(.16)
Salt Lake City, UT	1.90	1.90	.00
Phoenix, AZ	2.52	2.35	(.17)
Seattle, WA	1.90	1.90	.00

Analysis Based on Evaluation Criteria

Option 1A performs equal to or better than the current Class I system in each of the evaluation criteria. This is largely explained by the adjustments made to the current system based on current marketing conditions and USDSS model results. However, Option 1A leaves essentially unchanged the role of market forces and the Federal government, in determining Class I prices and the incentives to move milk to deficit areas.

Option 1A was evaluated against the objective criteria as follows:

1. Ensure an adequate supply of milk for fluid use. Option 1A performs essentially the same as the current price structure in ensuring an adequate supply of milk for fluid use. Proposed changes from current differential levels by region or locality to more accurately reflect current milk supply-demand conditions and inter-market price alignment contributes to more appropriate market by market supply adjustments. Option 1A will have minimal impacts on farm level milk prices and should continue to ensure adequate supplies of milk for fluid use.

2. Recognize quality (Grade A) value of milk. Option 1A does recognize the quality value (Grade A) of milk through the addition of a differential that begins at \$1.60 per hundredweight in the base zone.

3. Provide appropriate market signals. Option 1A adjusts and refines the existing Class I price structure to more accurately reflect recent prices. In some geographical areas, Class I differentials would be modestly increased. In certain other areas, Class I differentials would be lowered somewhat, suggesting that they now exceed levels necessary to adequately supply the associated markets with their fluid milk needs.

4. Recognize value of milk at location. The spatial values of milk as reflected in Option 1A recognize the value of milk at location more accurately than the current system for two principal reasons. First, in structuring the differentials in Option 1A, the effect of current Class I differential levels on milk supplies, demand, and dairy

farmer returns regionally during the past decade were reviewed. Second, the results of the USDSS model, explained previously, that obtained the relative values of milk and milk components at geographic locations throughout the United States, were used. Together, the results of these studies provided the basis to construct the Option 1A price surface.

5. Facilitate orderly marketing with coordinated system of prices. A primary element of Option 1A is the coordination of Class I differential levels and location adjustments within and among regional marketing areas. As such, Option 1A is an improvement over the current price structure which evolved in a piecemeal fashion. The Class I differentials and location adjustments in Option 1A will facilitate orderly marketing of milk for fluid use through the nationwide coordination of prices.

6. Recognize handler equity with regard to raw product costs. Class I differentials proposed under Option 1A reflect differences in economic costs of procuring and marketing milk depending upon geographic location. This coordination and alignment of prices based upon cost differences and current marketing conditions better ensures handlers of equity in competing for available milk supplies and sales of fluid milk products.

Option 1A was evaluated against the objective criteria as follows:

1. Minimize regulatory burden. Option 1A would not change the regulatory burden of the Federal order program. Because Option 1A is similar to the current Class I pricing structure, it would not result in increased reporting, record keeping, compliance, or administrative costs to handlers. The role of regulation in influencing Class I prices would also be about the same as the current system.

2. Minimize impact on small businesses. In regions where more of the actual value of fluid milk would be reflected in the differentials than is currently reflected, small businesses may have a marginal improvement in

their relative competitive bargaining position vis-a-vis large businesses. This is based on the concept that large businesses (producers, cooperatives or handlers) are better able to negotiate premiums above minimum order prices due to advantages attained from size. Overall, this option is not expected to materially impact small businesses differently than the current price structure.

3. Provide long-term viability. To the extent the proposed location adjusted Class I differentials under Option 1A will correct instances of price misalignment and more accurately reflect the economic value of milk by location, the long-term viability of Option 1A is expected to exceed that of the current price structure.

Option 1A utilizes the USDSS model results as a basis for development. All results, including the preliminary results based on 1993 annual data and the preliminary results based on May 1995 and October 1995 data, were used. However, the variance of price differentials under Option 1A are somewhat less than the range in relative values of milk (shadow prices) determined through the USDSS model. There are several explanations for the differences, including the fact that the model generates value differences between geographic locations, not actual prices. That is, it computes the marginal value of an additional hundredweight of milk supplied to a plant at a specific location for fluid use. This approach results in a pricing or value surface for Class I milk but does not take into account marketwide pooling and other factors affecting the supply of and demand for milk.

Since the USDSS model only determines the spatial value differences for fluid milk between location and not the price level, Option 1A utilizes \$1.60 as the minimum price in the three base zones. Currently, the lowest differential in Federal orders is \$1.04 (\$1.20 in Minneapolis) in the Upper Midwest order.

A review of current marketing practices has revealed that the \$1.04 per

hundredweight base zone differential may not be established at a level high enough to ensure adequate milk supplies for fluid use. First, a portion of the Class I differential must reflect the value associated with maintaining Grade A milk supplies since this is the only milk available for fluid use. Originally the differential needed to be established at a level that would encourage conversion from Grade B to Grade A status. With approximately 96 percent of all milk already converted to Grade A,²⁶ this value now needs to reflect the cost of maintaining Grade A milk supplies. Although it may be difficult to quantify the cost to maintain Grade A status, there are specific associated costs, as described below.

There are several requirements for producers to meet to convert to a Grade A dairy farm and then maintain it. A Grade A farm requires an approved water system (typically one of the greatest conversion expenses), specific facility construction and plumbing requirements, certain specifications on the appearance of the facilities, and specific equipment. After achieving Grade A status, producers must maintain the required equipment and facilities, and adhere to certain management practices.²⁷ Often, this will require additional labor, resource, and utility expenses. It has been estimated that this value may be worth

approximately \$0.40 per hundredweight.²⁸

Traditionally, the additional portion of the Class I differential reflects the marketing costs incurred in supplying the Class I market. These marketing costs include such things as seasonal and daily reserve balancing of milk supplies, transportation to more distant processing plants, shrinkage, administrative costs, and opportunity or "give-up" charges at manufacturing milk plants that service the fluid Class I markets. This value has typically represented approximately \$0.60 per hundredweight.

Originally recognizing these two factors in the base zone was sufficient to bring forth enough milk to meet Class I demands given the abundant volumes of milk and the abundance of manufacturing plants. However, recognizing just these two factors at the values specified may no longer be adequate to ensure sufficient supplies of Class I milk in the Upper Midwest region.

The Upper Midwest region is considered a surplus market for fluid use because its average Class I utilization is only approximately 20 percent.²⁹ However, as a result of the abundance of manufacturing facilities that require milk, the Upper Midwest region is actually a highly competitive area in which to procure Grade A milk. Because of this competitiveness,

manufacturing facilities are willing to pay more than the Federal order minimum price, the basic formula price (BFP), for Grade A milk used in manufactured products. For example, during 1995, Minnesota manufacturing plants paid, on average, \$0.77 per hundredweight more than the BFP for Grade A milk; price premiums in excess of the BFP ranged from \$0.38 per hundredweight in June to \$1.24 per hundredweight in December. In 1996, the average pay price for Grade A manufacturing milk in Minnesota was \$0.94 per hundredweight more than the BFP, ranging from \$0.68 per hundredweight in October to \$1.18 per hundredweight in November. Similar pay price patterns occur in Wisconsin for Grade A milk used in manufactured products. In 1995, the average pay price for Grade A milk used in manufacturing was \$0.85 per hundredweight more than the BFP, with pay prices ranging from \$0.55 per hundredweight above the BFP in July to \$1.22 per hundredweight in December. During 1996, the average pay price for Grade A milk used in manufacturing was \$0.93 per hundredweight more than the BFP, ranging from \$0.82 per hundredweight (January) to \$1.10 per hundredweight (September). Table 7 sets forth specific data for pay prices for Grade A milk used in manufacturing for 1995 and 1996.

TABLE 7.—COMPARISON OF PRICES PAID FOR GRADE A MILK USED IN MANUFACTURING PRODUCTS IN MINNESOTA AND WISCONSIN TO THE BASIC FORMULA PRICE

Year/Month	Basic formula price	Minnesota		Wisconsin	
		Grade A pay price @ 3.5% ¹	Diff. between BFP and grade A pay price	Grade A pay price @ 3.5% ¹	Diff. between BFP and grade A pay price
\$ /hundredweight					
1995:					
January	11.35	12.13	0.78	12.24	0.89
February	11.79	12.56	0.77	12.63	0.84
March	11.89	12.52	0.63	12.64	0.75
April	11.16	11.77	0.61	11.92	0.76
May	11.12	11.67	0.55	11.79	0.67
June	11.42	11.80	0.38	12.07	0.65
July	11.23	11.81	0.58	11.78	0.55
August	11.55	12.14	0.59	12.14	0.59
September	12.08	12.95	0.87	13.04	0.96
October	12.61	13.66	1.05	13.74	1.13
November	12.87	14.11	1.24	14.09	1.22
December	12.91	14.12	1.21	14.13	1.22

²⁶ Milk Production, Disposition and Income, 1996 Summary, National Agricultural Statistics Service, USDA, DA 1-2 (97).

²⁷ References: *Grade "A" Pasteurized Milk Ordinance*, 1993 Revision, U.S. Department of Health and Human Services, Public Health Service, Food and Drug Administration and *General Instructions for Performing Farm Inspections According to the USDA Recommended*

Requirements for Manufacturing Purposes and Its Production and Processing For Adoption by State Regulatory Agencies, USDA, AMS, Dairy Division, August 1, 1976.

²⁸ This is the value associated with Class I milk. The amount of this value actually returned to a producer is dependent upon a marketing order's Class I utilization and is reflected in the blend price. For example, in the proposed Upper Midwest

order approximately \$.06/hundredweight would be returned to producers to cover the costs associated with maintaining Grade A milk supplies.

²⁹ Federal Milk Order Statistics, 1996 Annual Summary, USDA, Marketing and Regulatory Programs, Agricultural Marketing Service, Dairy Division, Statistical Bulletin 938.

TABLE 7.—COMPARISON OF PRICES PAID FOR GRADE A MILK USED IN MANUFACTURING PRODUCTS IN MINNESOTA AND WISCONSIN TO THE BASIC FORMULA PRICE—Continued

Year/Month	Basic formula price	Minnesota		Wisconsin	
		Grade A pay price @ 3.5% ¹	Diff. between BFP and grade A pay price	Grade A pay price @ 3.5% ¹	Diff. between BFP and grade A pay price
Average	11.83	12.60	0.77	12.68	0.85
1996:					
January	12.73	13.78	1.05	13.55	0.82
February	12.59	13.56	0.97	13.44	0.85
March	12.70	13.68	0.98	13.72	1.02
April	13.09	14.01	0.92	14.11	1.02
May	13.77	14.57	0.80	14.65	0.88
June	13.92	14.71	0.79	14.78	0.86
July	14.49	15.32	0.83	15.39	0.90
August	14.94	16.00	1.06	15.96	1.02
September	15.37	16.33	0.96	16.47	1.10
October	14.13	14.81	0.68	15.06	0.93
November	11.61	12.79	1.18	12.47	0.86
December	11.34	12.39	1.05	12.18	0.84
Average	13.39	14.33	0.94	14.32	0.93

¹ Fluid Grade A pay price for milk used in all manufacturing products in Minnesota and Wisconsin as reported by the National Agricultural Statistical Service adjusted by butterfat differential used under Federal milk orders.

Because manufacturing facilities are willing to pay these values above the BFP to ensure adequate supplies of milk into their plants, fluid processors must pay at least these values to attract the necessary supplies of fluid milk to the bottling plants. Although data indicating the exact value that fluid plants are willing to pay to ensure this supply is not published, an indication of the market value of this milk can be obtained from the announced cooperative Class I prices.³⁰ Other than in Miami, Florida, which is a deficit Class I market with a 1996 annual average Class I utilization of nearly 90 percent,³¹ the announced cooperative Class I prices are the highest in the Upper Midwest region. These prices range from \$1.19 per hundredweight above the minimum Class I price in Minneapolis, Minnesota, to \$1.79 per hundredweight above the minimum Class I price in Milwaukee, Wisconsin, and Chicago, Illinois.

Option 1A presumes that the \$1.04 per hundredweight minimum Class I differential is no longer adequate to ensure a sufficient supply of milk due to the competitive nature of the manufacturing facilities in this region. Thus, Option 1A establishes an additional competitive factor into the development of the base zone Class I

differential. Option 1A values this competitive factor to be worth about \$0.60 per hundredweight. This value reflects approximately two-thirds of the actual competitive costs incurred by fluid plants to simply compete with manufacturing plants for a supply of milk.

An additional benefit of establishing the minimum Class I differential at a level that more accurately reflects the actual value of milk for fluid purposes is the added monies generated in the Federal order pool. Class I milk provides the vast majority of pool value in Federal orders. If an order has a low Class I differential and a low Class I utilization, it frequently does not have enough pool value to provide proper price signals to pool participants. In these orders, the Class I price is established by the suppliers of milk at levels above the Federal order minimums. When these over-order markets dictate substantially higher prices than the order minimums there is a risk that handlers may not face equal raw product costs for various reasons. Thus, having a larger proportion of the actual value of Class I milk in the market order pool in these areas, than is now the case, should promote pricing equity among market participants. The \$1.60 minimum differential level proposed is perceived to be the lowest value necessary under present supply and demand conditions to maintain stable and viable pools of milk for Class I use in markets that are predominantly manufacturing oriented. Applying this minimum differential to each of the three low pricing areas will ensure that

low utilization and surplus markets will have similar differentials. However, having a larger portion of Class I value pooled could mute price signals to producers more than prices determined strictly by market forces. If the blend price exceeds the marginal value of milk in manufacturing, there would be an incentive to overproduce for fluid needs.

Quantitative analysis using the ERS multi-regional model which assumed the eleven market order consolidation, four classes of utilization, and the BFP as proposed, suggests that most producers for the 6-year average would see little to modest changes in revenue due to Class I price increases resulting from Option 1A when compared to the baseline. However, some producers would experience Class I price decreases. Producers located in the following Federal milk markets would experience revenue reductions due to average Class I price decreases: New Mexico-West Texas—(\$0.19/cwt), Eastern Colorado—(\$0.12/cwt), Central Arizona—(\$0.11/cwt), Southwest Plains—(\$0.11/cwt), and Texas—(\$0.10/cwt). All other orders for the 6-year average would have a Class I price increase. The Chicago Regional, Michigan Upper Peninsula, and Upper Midwest orders would experience the largest increases: \$0.46, \$0.51, and \$0.56 per hundredweight, respectively.

Overall, the magnitude of price and income changes under Option 1A is small when compared to the baseline. Option 1A results in a 10-cent increase in the average Class I price for all current Federal orders. Further details

³⁰ Table 35—1996 Annual Average Announced Cooperative Class I Prices in Selected Cities, Dairy Market Statistics, 1996 Annual Summary, USDA, AMS.

³¹ Federal Milk Order Statistics, 1996 Annual Summary, USDA, Marketing and Regulatory Programs, Agricultural Marketing Service, Dairy Division, Statistical Bulletin 938.

of the impact of these Class I price changes on the all-milk price and cash receipts based on the model results are available in the economic analysis statement.

Option 1B—Relative Value-Specific Differentials. Option 1B establishes a nationally coordinated system of relative value-specific Class I price differentials and adjustments that recognizes several low pricing areas. Option 1B relies on a least cost optimal solution from the USDSS Cornell model to develop a Class I price structure that is based on the most efficient assembly and shipment of milk and dairy products to meet all market demands for milk and its products.

The results of the USDSS model provide information regarding the

relationship of prices between geographic locations but do not determine the level of Class I differentials. Option 1B utilizes geographic relationships as its foundation and maintains the current Class I differential of \$1.20 at Minneapolis, Minnesota. A location adjusted price differential for every county is established by evaluating differences between nearby Class I differential pricing points generated by the model. The marginal values (shadow prices) are used to determine the price structure because they reflect the value of additional milk supplied to a plant at a specific location for fluid use. This price surface recognizes several low pricing areas located primarily in the Upper Midwest and Western regions.

Option 1B would move the dairy industry into a more market-oriented system. By establishing differentials on the basis of optimal milk movements, market conditions will play a greater role in determining Class I prices. To the extent that higher Class I prices are needed and negotiated to attract milk supplies, the higher prices will accrue to those producers who service the fluid market. Hence, Option 1B places more emphasis on negotiations between dairy farmers and processors to determine actual Class I prices. The location adjusted differentials established for each county are set forth in Maps 3A, 3B, and 3C and in General Provisions § 1000.52. Table 8 sets forth the location adjusted differentials at selected cities.

TABLE 8.—COMPARATIVE CLASS I DIFFERENTIALS AT SELECTED CITIES UNDER OPTION 1B—RELATIVE VALUE-SPECIFIC DIFFERENTIALS

City	Current	Option 1B	Difference
New York City, NY	3.14	2.07	(1.07)
Charlotte, SC	3.08	1.89	(1.19)
Atlanta, GA	3.08	2.46	(0.62)
Tampa Bay, FL	3.88	3.81	(0.07)
Cleveland, OH	2.00	1.54	(0.46)
Kansas City, MO	1.92	1.45	(0.47)
Minneapolis, MN	1.20	1.20	0.00
Chicago, IL	1.40	1.65	0.25
Dallas, TX	3.16	1.68	(1.48)
Salt Lake City, UT	1.90	1.08	(0.82)
Phoenix, AZ	2.52	1.14	(1.38)
Seattle, WA	1.90	1.00	(0.90)

Because Option 1B would involve changes in both the level of Class I differentials and the method for establishing them, it is proposed that they be implemented through a transitional phase-in program. The use of a phase-in program would provide dairy farmers and processors the opportunity to adjust marketing

practices to adapt to more market-determined Class I prices.

Three possible alternatives are presented for phasing in Option 1B. Each utilizes the difference between the current differentials and the Option 1B differentials as the basis of the phase-in over a 5-year period, beginning in 1999 and being completed by 2003. The first

transitional option simply spreads the phase-in over the 5-year period, with 20 percent of the adjustment in 1999, 40 percent in 2000 and so forth. The base differentials resulting from this transitional phase-in are set forth in Table 9. The first alternative would be to phase-in to these differentials as shown in Table 9.

TABLE 9.—OPTION 1B BASE DIFFERENTIALS

City	Current	Option 1B—Base differentials ¹				
		1999	2000	2001	2002	2003
Dollars per hundredweight						
New York City, NY	3.14	2.93	2.71	2.50	2.28	2.07
Charlotte, NC	3.08	2.84	2.60	2.37	2.13	1.89
Atlanta, GA	3.08	2.96	2.83	2.71	2.58	2.46
Tampa Bay, FL	3.88	3.87	3.85	3.84	3.82	3.81
Cleveland, OH	2.00	1.91	1.82	1.72	1.63	1.54
Kansas City, MO	1.92	1.83	1.73	1.64	1.54	1.45
Minneapolis, MN	1.20	1.20	1.20	1.20	1.20	1.20
Chicago, IL	1.40	1.45	1.50	1.55	1.60	1.65
Dallas, TX	3.16	2.86	2.57	2.27	1.98	1.68
Salt Lake City, UT	1.90	1.74	1.57	1.41	1.24	1.08
Phoenix, AZ	2.52	2.24	1.97	1.69	1.42	1.14

TABLE 9.—OPTION 1B BASE DIFFERENTIALS—Continued

City	Current	Option 1B—Base differentials ¹				
		1999	2000	2001	2002	2003
Seattle, WA	1.90	1.72	1.54	1.36	1.18	1.00

¹ Base differential obtained by taking the difference between the current differential and the final Option 1B differential (year 2003) and multiplying by 20 percent. This value is then subtracted from the current differential to yield the 1999 base differential. This value is then deducted from each consecutive year's value until the Option 1B differentials are achieved in 2003.

The second alternative for phasing-in Option 1B would consist of adding a decreasing "transitional payment" to the base differential. It would be equal to the decrease in revenue that would otherwise occur during the phase-in period of Option 1B. Over this four-year period, it is projected that \$388.6 million would be removed from the Federal order system through the lowered Class I differential. To provide the industry an opportunity to prepare

for the changed pricing structure under Option 1B, a transitional payment would be added to the base differential for Class I milk. The payment would be higher in the first year and gradually be reduced thereafter to result in implementation of the Option 1B differentials in 2003. The additions to the base differential would equal \$0.55 per hundredweight in 1999, \$0.35 per hundredweight in 2000, \$0.20 per hundredweight in 2001, and \$0.10 per

hundredweight in 2002. This offsetting of revenue is designed to temporarily reduce the impacts of implementing Option 1B, thus allowing producers an opportunity to adjust their marketing practices to adapt to more market-determined pricing. Table 10 sets forth the location adjusted Class I differentials under this revenue-neutral phase-in alternative for selected cities.

TABLE 10.—OPTION 1B CLASS I DIFFERENTIALS WITH REVENUE NEUTRAL PHASE-IN PAYMENTS

City	Current	Class I diff. with revenue neutral				
		1999 ¹	2000 ²	2001 ³	2002 ⁴	2003 ⁵
Dollars per hundredweight						
New York City, NY	3.14	3.48	3.06	2.70	2.38	2.07
Charlotte, NC	3.08	3.39	2.95	2.57	2.23	1.89
Atlanta, GA	3.08	3.51	3.18	2.91	2.68	2.46
Tampa Bay, FL	3.88	4.42	4.20	4.04	3.92	3.81
Cleveland, OH	2.00	2.46	2.17	1.92	1.73	1.54
Kansas City, MO	1.92	2.38	2.08	1.84	1.64	1.45
Minneapolis, MN	1.20	1.75	1.55	1.40	1.30	1.20
Chicago, IL	1.40	2.00	1.85	1.75	1.70	1.65
Dallas, TX	3.16	3.41	2.92	2.47	2.08	1.68
Salt Lake City, UT	1.90	2.29	1.92	1.61	1.34	1.08
Phoenix, AZ	2.52	2.79	2.32	1.89	1.52	1.14
Seattle, WA	1.90	2.27	1.89	1.56	1.28	1.00

¹ 1999 applicable base differential from Table 9 plus \$0.55.

² 2000 applicable base differential from Table 9 plus \$0.35.

³ 2001 applicable base differential from Table 9 plus \$0.20.

⁴ 2002 applicable base differential from Table 9 plus \$0.10.

⁵ Final Option 1B differentials.

The third approach to phasing in Option 1B would consist of adding a decreasing "transitional payment" to the base differential that would enhance revenue beyond what the current Class I system would have generated during the four years of transitioning to Option 1B. During this four-year period, it is projected that \$878.4 million would be added to the Federal order system through the revenue-enhanced payment. This would result in a net increase of \$489.8 million added to the system once

the projected decrease resulting from Option 1B phased in during this period is deducted. This additional money would not only provide producers with an opportunity to prepare and restructure their marketing practices to adapt to more market-determined pricing but would also allow them to obtain the education and resources necessary to become more effective in a more market-oriented environment. Again, the payment in the first year would be the highest with reductions

occurring thereafter to result in implementation of the Option 1B differentials by 2003. The addition to the base differential would equal \$1.10 per hundredweight in 1999, \$0.70 per hundredweight in 2000, \$0.40 per hundredweight in 2001, and \$0.20 per hundredweight in 2002. Table 11 sets forth the location adjusted Class I differentials under this revenue-enhanced alternative for selected cities.

TABLE 11.—OPTION 1B CLASS I DIFFERENTIALS WITH REVENUE ENHANCED PAYMENTS

City	Current	Class I diff. with revenue enhancement				
		1999 ¹	2000 ²	2001 ³	2002 ⁴	2003 ⁵
Dollars Per Hundredweight						
New York City, NY	3.14	4.03	3.41	2.90	2.48	2.07
Charlotte, NC	3.08	3.94	3.30	2.77	2.33	1.89
Atlanta, GA	3.08	4.06	3.53	3.11	2.78	2.46
Tampa Bay, FL	3.88	4.97	4.55	4.24	4.02	3.81
Cleveland, OH	2.00	3.01	2.52	2.12	1.83	1.54
Kansas City, MO	1.92	2.93	2.43	2.04	1.74	1.45
Minneapolis, MN	1.20	2.30	1.90	1.60	1.40	1.20
Chicago, IL	1.40	2.55	2.20	1.95	1.80	1.65
Dallas, TX	3.16	3.96	3.27	2.67	2.18	1.68
Salt Lake City, UT	1.90	2.84	2.27	1.81	1.44	1.08
Phoenix, AZ	2.52	3.34	2.67	2.09	1.62	1.14
Seattle, WA	1.90	2.82	2.24	1.76	1.38	1.00

¹ 1999 applicable base differential from Table 9 plus \$1.10.
² 2000 applicable base differential from Table 9 plus \$0.70.
³ 2001 applicable base differential from Table 9 plus \$0.40.
⁴ 2002 applicable base differential from Table 9 plus \$0.20.
⁵ Final Option 1B differentials.

Analysis Based on Evaluation Criteria

Option 1B performs equal to or better than the current system when combined with a phase-in program option because it provides the industry time to adapt to a more market-oriented system.

Option 1B was evaluated against the objective criteria as follows:

1. *Ensure an adequate supply of milk for fluid use.* Option 1B suggests lower differentials than current levels in most of the proposed markets when using a \$1.20 differential at Minneapolis, Minnesota. Option 1B relies more on the use of over-order premiums in many areas to attract adequate milk supplies for fluid purposes. Over-order prices are useful tools for allowing the market to find the final value of Class I milk, and Option 1B would ensure an adequate supply of milk for fluid use by rewarding those producers who service the Class I market needs. The use of "transitional payment" alternatives would ensure an adequate supply of milk for fluid purposes by providing the industry time to adapt to adjust their marketing practices in adapting to more market-determined pricing.

2. *Recognize quality (Grade A) value of milk.* Option 1B recognizes the quality (Grade A) value of milk through the use of a differential added to the basic formula price.

3. *Provide appropriate market signals.* Under Option 1B, greater reliance is placed on market forces to establish prices which will allow for clearer transmission of supply and demand signals between producers and consumers than does the current system.

4. *Recognize value of milk at location.* Option 1B does recognize the value of

milk at location. Option 1B is based on the least cost movement of milk and dairy products based on the May 1995 results of the USDSS model. Thus the resulting price structure reflects the most efficient assembly and transportation of milk and dairy products and performs better than the current system.

5. *Facilitate orderly marketing with coordinated system of prices.* Like Option 1A, Option 1B also establishes a coordinated system of differentials and location adjustments that sets a minimum value for Class I milk in every county. Prices will be aligned within and among orders, thereby facilitating orderly marketing of milk.

6. *Recognize handler equity with regard to raw product costs.* Class I differentials proposed under Option 1B reflect differences in economic costs of procuring and marketing milk depending on geographic location. This coordination and alignment of minimum prices provides an equitable foundation upon which handlers can compete for available milk supplies and sales of fluid products in a more market-oriented environment.

Option 1B was evaluated against the administrative criteria as follows:

1. *Minimize regulatory burden.* Option 1B would not change the regulatory burden of the Federal order program in terms of reporting, recordkeeping, compliance, and administrative costs to handlers. The role of regulation in determining minimum prices would be reduced, as more responsibility would be placed on market forces.

2. *Minimize impact on small businesses.* Under Option 1B, a

substantial part of the Class I value needed to attract adequate milk supplies would likely come from over-order payments negotiated outside the Federal order system.

Smaller, less efficient businesses would likely have a greater responsibility under Option 1B to bargain with processors for over-order premiums that adequately cover their costs. With processors less likely to face similar raw product costs, less efficient small processors may have to negotiate and/or sustain over-order price levels necessary to attract and maintain a sufficient supply of milk, while efficient large businesses may be in a better competitive position to do this. The use of a transitional payment program would help provide less efficient small businesses make the needed investments to move to a more competitive position in the market.

3. *Provide long-term viability.* When Option 1B is combined with one of the transitional phase-in program options, the long-term viability of Option 1B is increased and is expected to exceed that of the current price structure. Gradually moving from a regulated system to one that is less regulated will require adaptation of all entities within the dairy industry. A transitional period will allow market participants to make necessary adjustments in marketing practices to continue in the industry for years to come.

Option 1B would establish a market-oriented approach to Class I pricing, by reducing the traditional role the Federal order program has maintained with regards to Class I pricing. Historically the Class I price established under Federal orders represented the

minimum value of Class I milk in the marketplace based on the cost of maintaining Grade A milk and additional marketing costs with the cost of alternative milk supplies placing an upper limit on this value. Option 1B provides an opportunity for free-market conditions to determine more of the value of fluid milk, but prices would still be undergirded by minimum prices based on the best available estimates of milk transportation costs. Ultimately, Option 1B should promote more market efficiencies; however, adjustments will be required by both producers and processors.

Quantitative Analysis

Using ERS multi-regional model analyses of the 11 order consolidations, four classes of utilization, and a Class I price mover as proposed, suggests that most producers would experience lower prices, when compared to the baseline, if Option 1B were phased-in with no transition assistance. The 6-year average Class I price in all current Federal order markets would decline \$0.37 per hundredweight. However, producers located in the Chicago Regional, Upper Midwest, Iowa, Central Illinois, Tampa Bay and Southeastern Florida orders would benefit from Class I price increases ranging from \$0.07 to \$0.28 per hundredweight. Producers in all other current orders would experience losses of revenue because of Class I price decreases ranging from \$0.03 to \$1.07 per hundredweight. The smallest decline occurs in the Upper Florida order with the greatest declines occurring in the current Carolina (\$ - 0.68), Middle Atlantic (\$ - 0.72), Southwest Plains (\$ - 0.76), Central Arizona (\$ - 0.80), Texas (\$ - 0.87) and Eastern Colorado (\$ - 1.07) orders.

Both the increases and decreases are mitigated somewhat by the amount of milk used in Class I. Thus no market would see declines in the all-milk price in excess of \$0.60 per hundredweight. Further details of the impact of these Class I price changes on the all-milk price and cash receipts based on the model results are available in the economic analysis statement.

Because current Federal order producers and processors have developed and designed their marketing practices based on the existing Class I price structure which has been in place for several years, moving immediately to a more market-oriented system could be disruptive for some producers and handlers. To reduce this marketplace disruption, Option 1B has been analyzed by the ERS multi-regional model in conjunction with transitional

phase-in program alternatives from the current differentials.

The revenue-neutral phase-in alternative from current differentials to Option 1B differentials would minimize the impact of Option 1B during the phase-in period. Through a gradual phase-in, both producers and processors would be given time to adjust their marketing practices in preparing for the new minimum Class I price levels. Results of the model analysis indicate that almost all producers would experience increased revenue because of Class I price increases during the first revenue-neutral phase-in year when compared to the baseline. In fact, the Class I price would be higher in all but one of the current Federal order markets. The price increases range from \$0.25 per hundredweight to \$0.59 per hundredweight and for all 32 Federal order markets the average first year Class I price would be up \$0.39 per hundredweight. In year two, producers located in 25 of the Federal order markets would continue to experience increased revenue because of Class I price increases compared with the baseline ranging from \$0.01 per hundredweight to \$0.48 per hundredweight. In year three, 17 orders would experience Class I price increases compared with the baseline. By year four, only the Florida, Upper Midwest, and parts of the Central areas would remain with price increases from the baseline.

Like the revenue-neutral phase-in, the revenue-enhancement phase-in would provide producers and processors a period of time to adjust their marketing practices in preparing for the new minimum price levels by initially providing payment assistance. The use of the revenue-enhancement phase-in option would provide producers with additional income to adjust their operations and obtain necessary education and resources to prepare for a more market-oriented system.

Results of the ERS multi-regional model indicate that during the first year, all current orders would experience Class I price increases over the baseline. In year two, all but one order would have increased Class I prices. By year three, 21 orders would continue to experience increases. During year four, 11 orders would maintain a Class I price increase over the baseline, while 21 orders would have price decreases of between \$0.01 per hundredweight and \$1.05 per hundredweight. Further details of the model results for both transitional payment program options are available in the economic analysis statement.

Comparison of Options 1A and 1B

Option 1A and Option 1B have similarities but rely on differing methods to establish a Class I price structure. First, both options recognize that milk has a location value. Secondly, both options establish a price surface that assigns a price to every county in the United States. Currently, a price at any particular location may vary depending upon the order under which the milk is pooled. Finally, both options utilized the USDSS model results to establish the price surface.

Although similar in these respects, the two pricing options differ on several issues. First, the options differ on the level at which Class I differentials are established. Option 1A is based on the premise that Class I differentials be established at a minimum price that reflects more closely the current value of the Class I milk based on local supply and demand conditions and agency judgement on the costs of obtaining alternative supplies of milk. Option 1B relies on the premise that a lower minimum price should be established strictly on the basis of the best available estimates of transportation costs to provide for a more market-oriented structure that allows dairy farmers and processors more freedom to negotiate fluid milk price levels.

Second, the two options differ in how the price surface should be established regardless of the level. Option 1A provides for a surface that is smoother and flows primarily from north to south and west to east. Option 1B establishes a price surface that is flatter throughout a majority of the United States and then increases significantly in the deficit milk production areas of the Southeast. A comparison of the price surfaces established under Options 1A and 1B from Minneapolis to Miami demonstrates this difference.

The total distance from Minneapolis to Miami is approximately 1775 miles. Since Atlanta is the first major metropolitan center located in the Southeast order, and is considered a deficit area, a review of the two price surfaces between Minneapolis and Atlanta and Atlanta and Miami highlights the differences in the price surface pattern. The distance between Minneapolis and Atlanta is about 1110 miles, or 63 percent of the total distance. The distance between Atlanta and Miami is approximately 665 miles, or 37 percent of the total distance.

Under Option 1A the differential established in Minneapolis is \$1.70 per hundredweight and \$1.20 per hundredweight under Option 1B. The Option 1A differential in Atlanta is

\$3.10 per hundredweight and under Option 1B, the differential is \$2.50 per hundredweight. The Class I differential in Miami under both options is about \$4.30 per hundredweight. The difference in differentials between Minneapolis and Atlanta under Option 1A is \$1.40 per hundredweight and \$1.30 per hundredweight under Option 1B. The difference in differentials between Atlanta and Miami under Option 1A is \$1.20 per hundredweight and \$1.80 per hundredweight under Option 1B. The total difference between Minneapolis and Miami under Option 1A is \$2.60 per hundredweight and \$3.10 per hundredweight under Option 1B.

Under Option 1A, the change in differentials from Minneapolis to Atlanta represents 54 percent of the total \$2.60 differential change with the differential changes from Atlanta to Miami representing 46 percent of the change. This helps to demonstrate that Option 1A results in a smoother, more

evenly dispersed Class I price surface from north to south.

Under Option 1B, the change in differentials from Minneapolis to Atlanta represents about 42 percent of the change whereas between Atlanta and Miami, 58 percent of the differential change is reflected in only 37 percent of the total distance. As demonstrated, Option 1B results in a price surface that is flatter over a greater portion of the United States and significantly steeper in the deficit areas of the Southeast.

Third, the options differ in their reliance on the USDSS model results. Option 1A recognizes the value associated with the model results but incorporates judgement on existing specific marketing conditions and practices to make adjustments to the model results. Option 1B, on the other hand, utilizes the most recently available USDSS model results to reflect optimal values for fluid milk at different locations that will promote market efficiencies within the dairy industry.

To further compare and analyze the impacts of Options 1A and 1B on

producers and processors, static Federal order pool analyses were completed. The pool analyses, although static, provide some indication on how the revenue will be distributed in the newly consolidated pools given the pricing structure. The pool analyses are based on October 1996 data. The analyses utilized all producer milk in each of the current Federal milk order pools. The classification of producer milk, including Class III-A milk, remained as it is currently classified under each order. The data were collected for all plants and prices and were adjusted for location. These data were then combined into the 11 proposed orders, and the pools were re-computed to reflect the impacts on the uniform price of consolidation only and then to reflect the impacts of consolidation combined with Option 1A and Option 1B price surfaces. Class II, Class III, and Class III-A and the basic formula price were held at the actual prices for October 1996. Table 12 sets forth the results of the analyses.

TABLE 12.—CONSOLIDATION PLUS OPTION 1A AND OPTION 1B PRICE STRUCTURE IMPACTS ON PROPOSED ORDERS' ESTIMATED UNIFORM PRICES—OCTOBER 1996

Proposed order	Estimated uniform price			Difference between pool impacts of consolidation plus options 1A & 1B and consolidation	
	Consolidation only (Col. 1)	Cons. plus option 1A (Col. 2)	Cons. plus option 1B (Col. 3)	Col. 2 - Col. 1	Col. 3 - Col. 1
	\$/hundredweight				
Northeast	16.55	16.60	16.07	0.05	(0.48)
Appalachian	17.27	17.57	16.53	0.30	(0.74)
Southeast	17.12	17.12	16.69	0.00	(0.43)
Florida	18.52	18.55	18.37	0.03	(0.15)
Midwest	15.95	16.01	15.64	0.06	(0.31)
Upper Midwest	14.78	14.85	14.79	0.07	0.01
Central	15.69	15.68	15.44	(0.01)	(0.25)
Southwest	16.54	16.45	15.66	(0.09)	(0.88)
Western	15.01	14.94	14.54	(0.07)	(0.47)
AZ-Las Vegas	15.91	15.82	15.28	(0.09)	(0.63)
Pacific NW	15.35	15.34	14.98	(0.01)	(0.37)

Table 12 provides an indication of the impacts of the two Class I pricing surfaces when combined with the proposed orders. This pool analysis does not reveal the impacts of the three possible alternatives for phasing-in Option 1B.

Conclusion

As previously indicated, the Department, based on the evidence and arguments currently before it, does not believe Options 2-5 or the other ideas discussed with less detail are viable options. But this proceeding is still a proposal. Therefore, commenters may

still present evidence or arguments regarding any of the Options or ideas.

All of the provisions of Federal milk marketing orders continue, in addition to a pricing surface as proposed under Options 1A or 1B. Thus, recordkeeping, prompt payment provisions, auditing plant receipts and utilization, and verification of farm weights and tests still continues. Both Option 1A and 1B also recognize that milk used for fluid purposes should be valued higher than milk used in other products. The two options differ in their approach for establishing minimum values for fluid milk. Option 1A focuses on establishing

a minimum price that reflects existing marketing conditions and the current value of milk used for fluid purposes. Option 1B focuses on reducing government intervention, to provide more room for market forces to determine the actual value of Class I milk.

At this time Option 1B is preferred for several reasons. First, this option is based on model results that reflects the best available estimates of least cost assembly and shipment of milk and dairy products to meet all dairy product demands. By promoting market efficiencies, it would be expected to

result in the most preferable allocation of resources over time.

Option 1B would move the dairy industry into a more market-determined pricing system. By lowering differentials, marketing conditions will have a greater impact on actual Class I prices in the form of higher prices that are provided to those producers who service the Class I market. In this way, the revenue necessary to obtain milk for fluid use may be minimized since the Class I value is not shared marketwide with those producers that do not service the fluid market.

U.S. agriculture is transitioning to a more market-determined environment, relying less on traditional government involvement typified by price and income support programs. This transition is emphasized in the 1996 Farm Bill, which specifically provided for the gradual phase-out of traditional price and income support programs, including the dairy price support program that has existed since 1950. Because Option 1B is more market oriented and reduces the government presence in establishing minimum Class I prices, three methods of transitioning to Option 1B are offered. One variation is a gradual phase-in to lower Class I differentials with no transition assistance to offset any lower revenue to dairy farmers that may occur. This variation would reduce Class I differentials in market order areas by 20 percent each year until the final Class I differentials under Option 1B are reached in 2003.

A second variation provides transition assistance at increases Class I differentials initially to offset reduced revenue that may occur to producers due to the decline in Class I differentials. In this variation, the Class I differentials in all market order areas would be increased by \$0.55 per hundredweight in the first year of the phase-in, \$0.35 per hundredweight in the second year, \$0.20 in the third year, and \$0.10 per hundredweight in the fourth year of phase-in. This level of assistance would restore income to dairy farmers that might be lost in the transition, and if the market generates additional premiums, these assistance levels would more than make up for lower producer revenue due to lower minimum Class I prices.

A third variation offers transition assistance that initially increases the Class I differentials even more, while still phasing toward a more market-oriented price surface by 2004. Under this variation, all Class I differentials in all market order areas would be increased by \$1.10 per hundredweight in the first year of phase-in, \$0.70 in the second year, \$0.40 in the third year, and \$0.20 in the fourth year before reaching the final Class I differentials described by Option 1B. The assistance provided by this variation would enable dairy farmers to make the adjustments necessary to succeed in a more market-oriented environment.

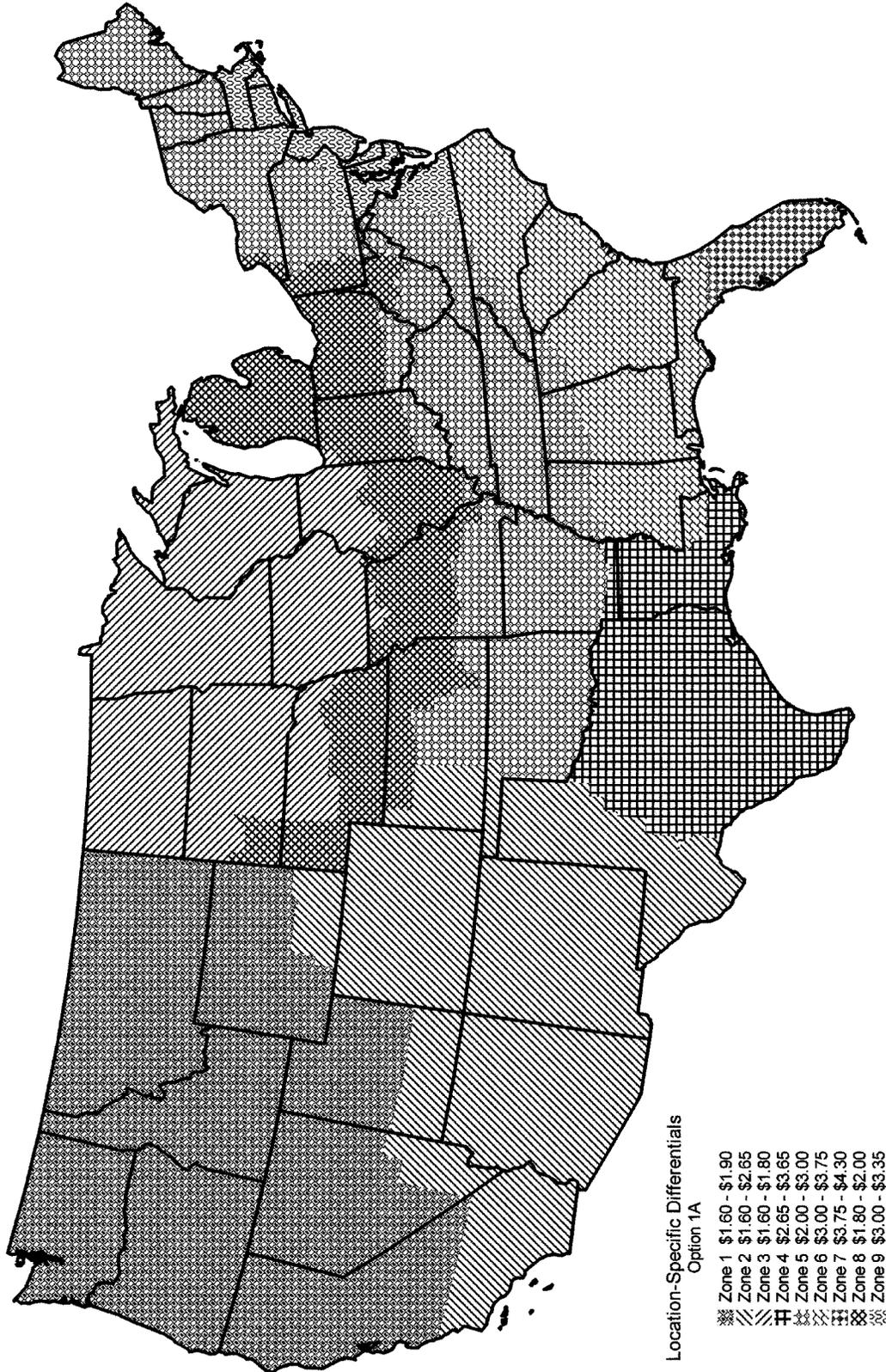
While Option 1B is preferred at this time, Option 1A and other pricing options are still under consideration.

Therefore, comments should address at least the following questions:

- Should the Class I price structure be designed to move the dairy industry towards a more market-oriented system that relies less on government regulation in establishing the pricing terms of trade between handlers and dairy farmers or should the Class I price structure be established at the estimated current value of Class I milk?
- What is the appropriate Class I differential level in surplus areas? How low can a Class I differential be established to ensure an adequate supply of fluid milk? What Class I differential level is necessary for producers to maintain sufficient revenue for ensuring an adequate supply of milk? Is that level \$1.00, \$1.60, or is it another value and why?
- Option 1B has been presented with three phase-in programs; which of these phase-in programs would be preferred and why? Is five years a sufficient time period for the industry to make necessary adjustments to move towards a more market-oriented, less governmentally regulated system?
- How will the California state program interact with either Option 1A or Option 1B?
- To what extent would consumers benefit from reduced differentials under Option 1B versus Option 1A?

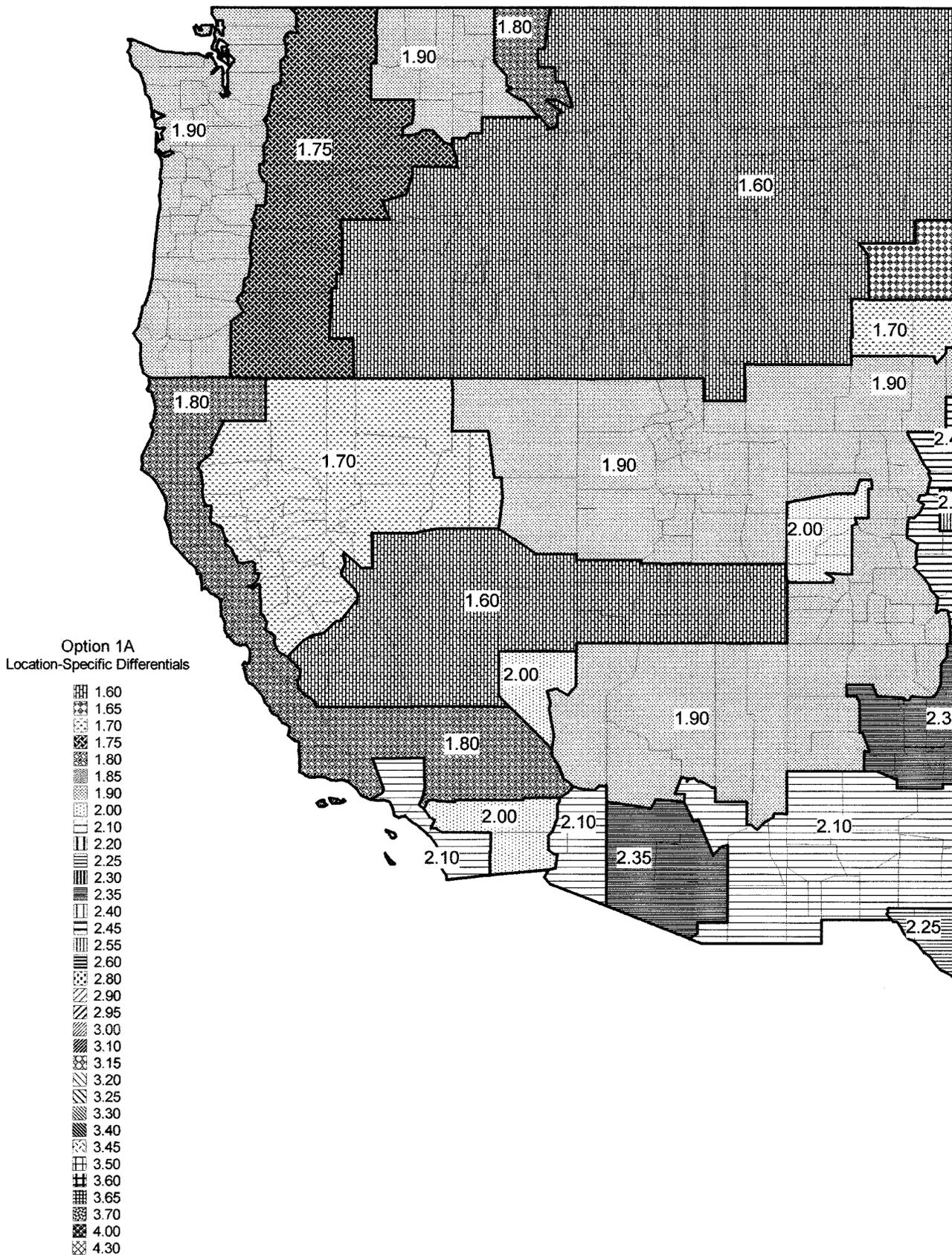
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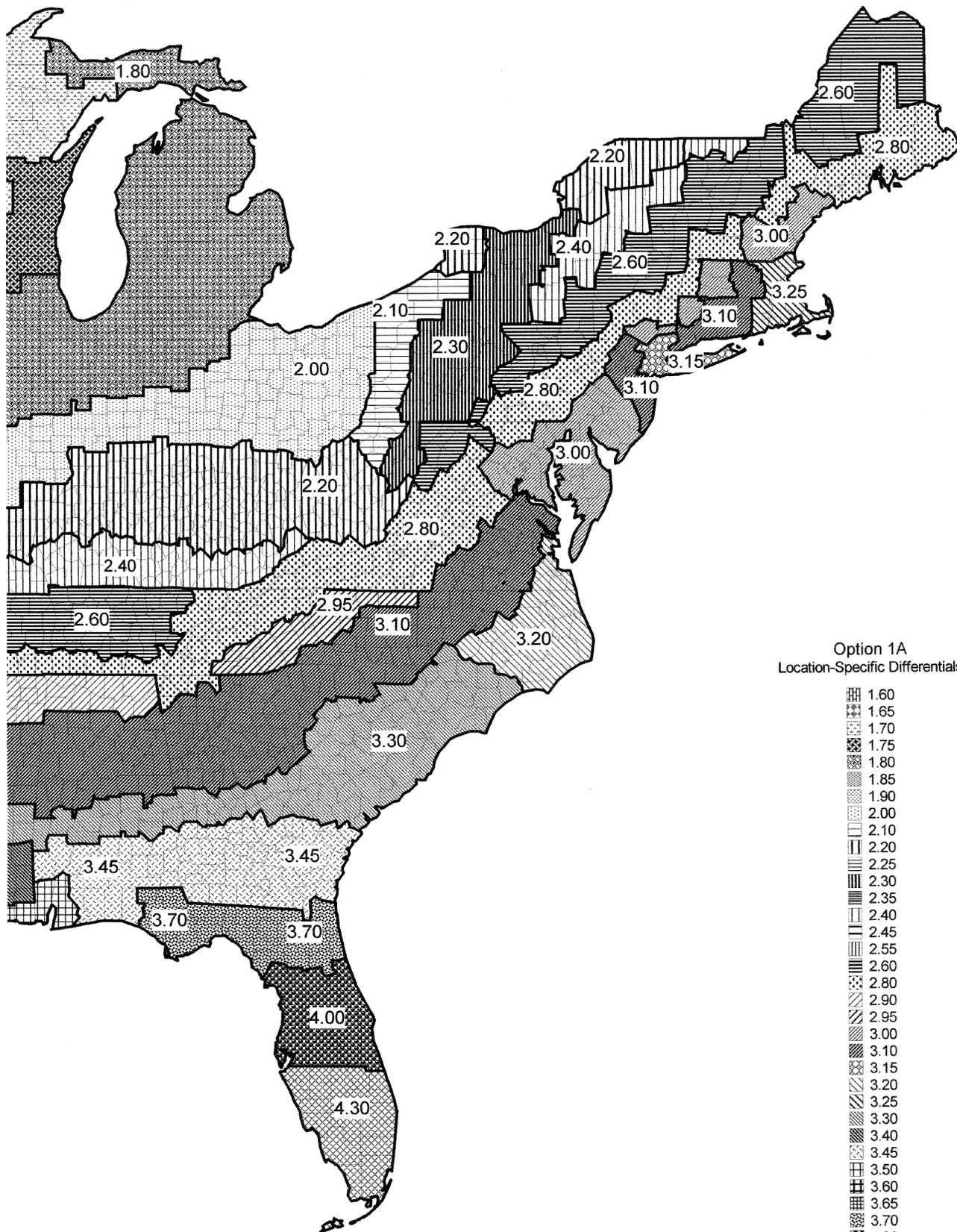
Option 1A - Location-Specific Differential Ranges Map 1

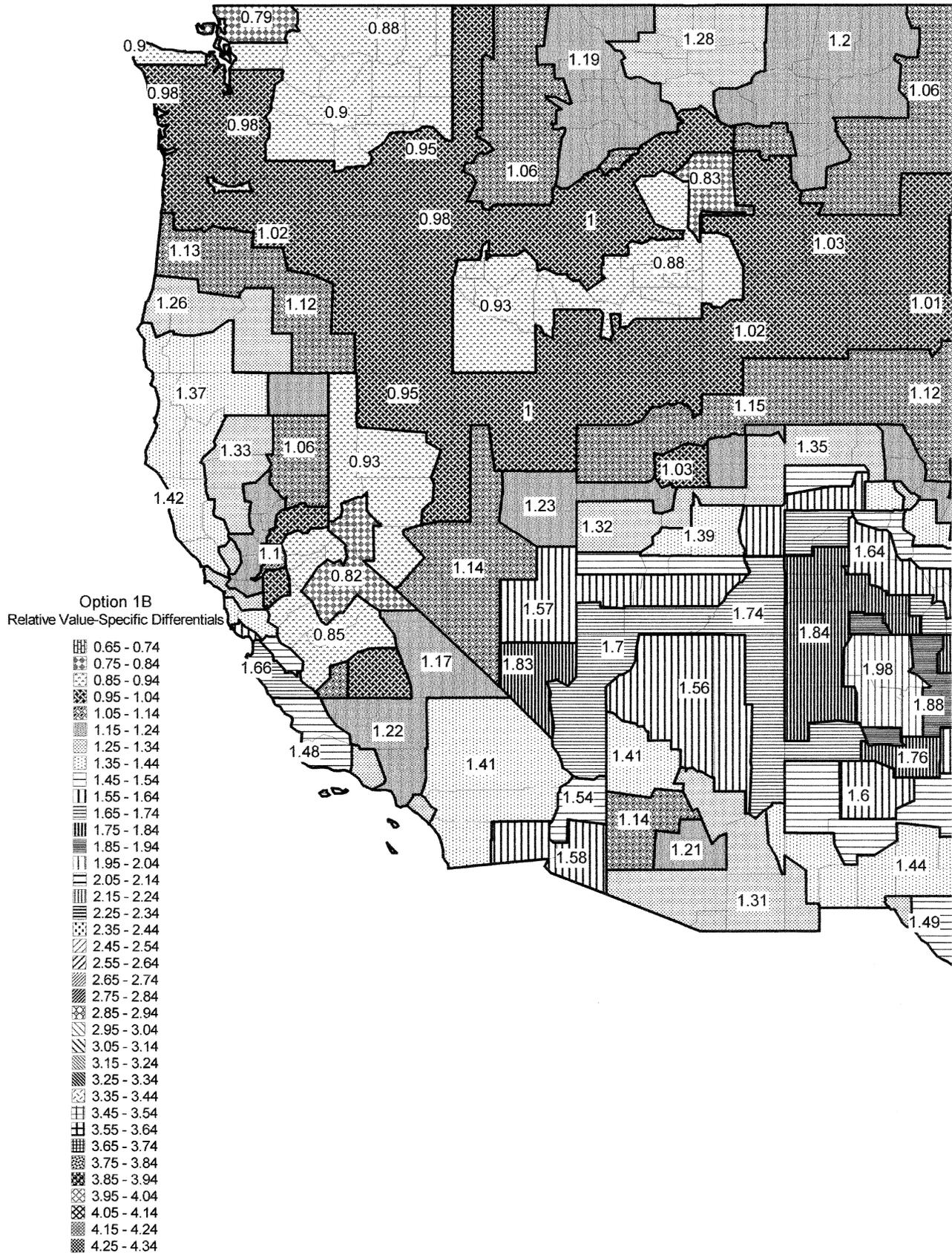


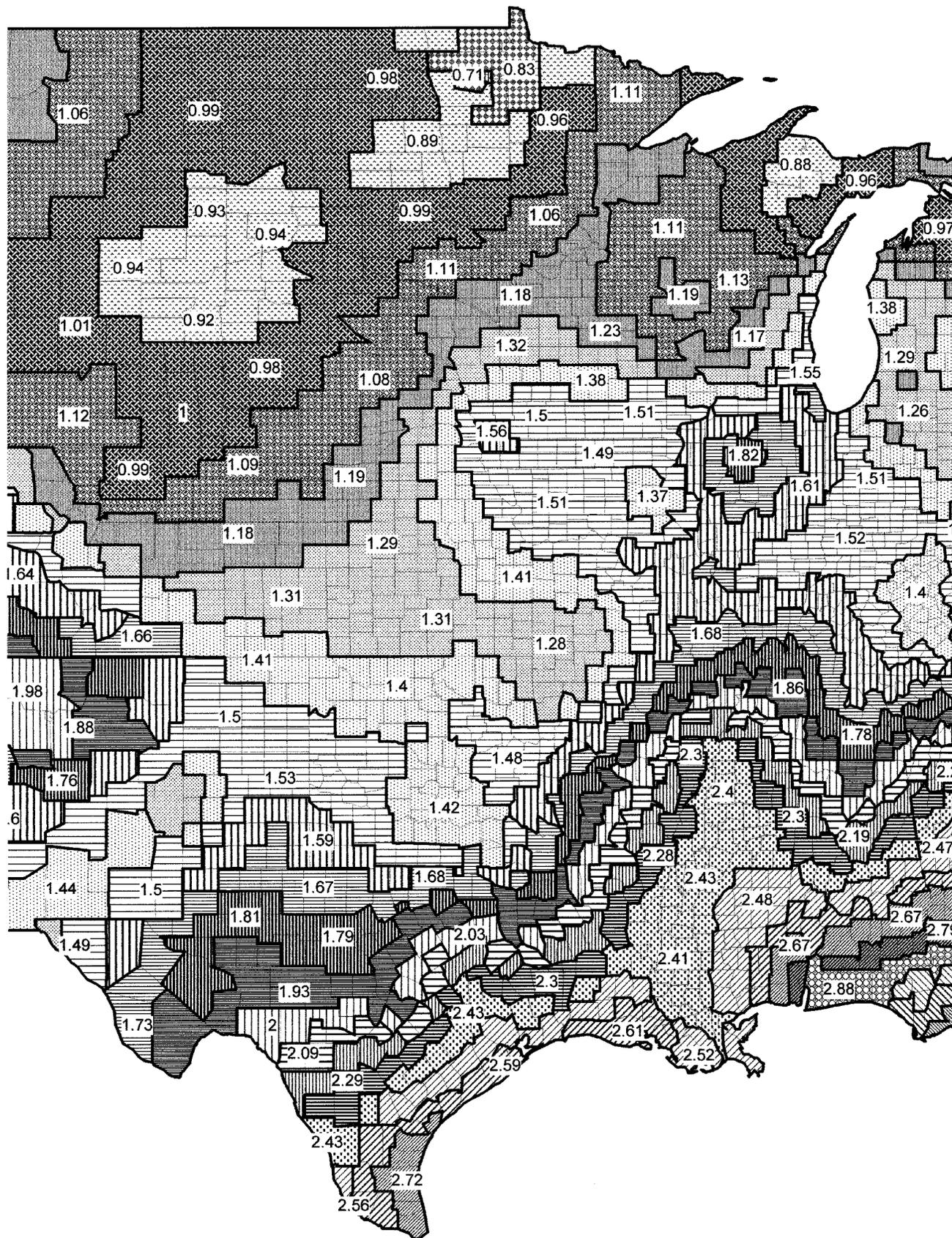
Location-Specific Differentials
Option 1A

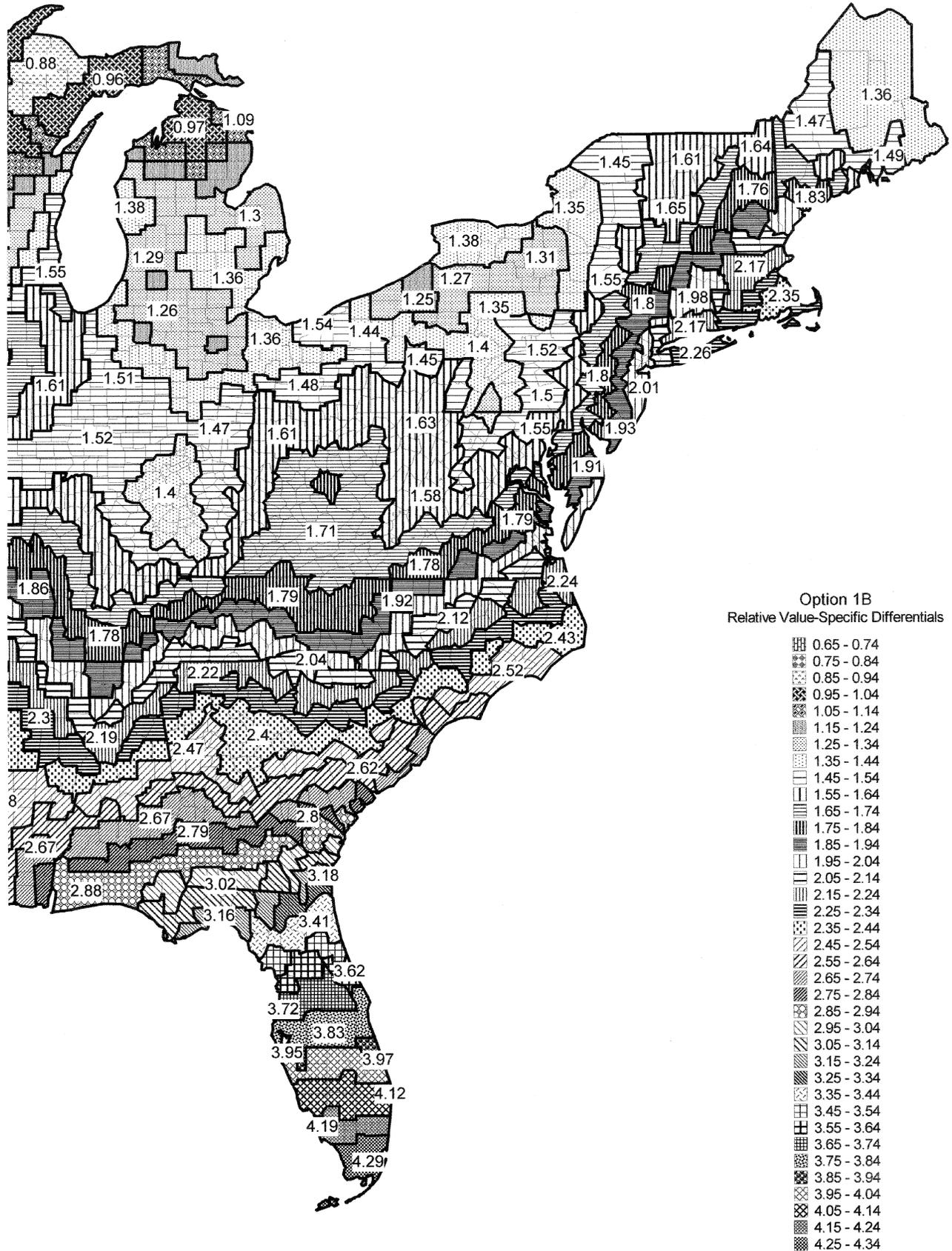
- Zone 1 \$1.60 - \$1.90
- Zone 2 \$1.60 - \$2.65
- Zone 3 \$1.60 - \$1.80
- Zone 4 \$2.65 - \$3.65
- Zone 5 \$2.00 - \$3.00
- Zone 6 \$3.00 - \$3.75
- Zone 7 \$3.75 - \$4.30
- Zone 8 \$1.80 - \$2.00
- Zone 9 \$3.00 - \$3.35











4. Classification of Milk

Under this proposal, the Federal milk order system would continue to contain uniform classification provisions, but with some modification. The proposed modifications would be consistent with the Agricultural Marketing Agreement Act of 1937, which requires that milk must be classified "in accordance with the form in which or the purpose for which it is used."

The proposed uniform provisions would provide for 4 classes of use. They are similar to the uniform classification provisions contained in the current orders. The purpose and application of the current classification and classification-related provisions are contained in the Department's final decisions that were issued February 19, 1974 (39 FR 9012), July 17, 1975 (40 FR 30119), February 5, 1993 (58 FR 12634), and October 20, 1993 (58 FR 58112). The differences in this proposal from the current classification system are discussed herein and are the result of a thorough review of Federal order classification provisions since passage of the 1996 Farm Bill.

Major proposed changes from the current classification plan include the formation of a new Class IV which includes milk used to produce nonfat dry milk (currently in Class III-A) and milk used to produce butter and other dry milk powders (currently in Class III). Other classification changes include reclassifying eggnog as a fluid milk product, moving cream cheese from Class III to Class II, broadening the Class II classification for infant formulas and meal replacement to include all such formulas meeting redefined criteria for such products regardless of the type of container they come in, removing the words "dietary use" from the fluid milk product definition and eliminating the term "filled milk."

In addition to the class uses of milk, consideration has been given in this proposal to a number of modifications related to order definitions and provisions that are necessary to administer an effective classified pricing plan. Related definitions include the definitions of fluid milk, filled milk, and commercial food processing establishments. Also, modifications have been considered for administrative rules related to the classification of milk. These include rules for classifying skim milk and butterfat that is transferred or diverted between plants, general rules pertaining to the classification of producer milk (including the determination of shrinkage and overage), rules describing how to allocate a handler's receipts of

skim milk and butterfat to the handler's utilization of such receipts, and provisions concerning the market administrator's reports and announcements concerning classification. The classification and classification-related provisions are proposed to be restructured and redrafted to achieve part of the goal of standardizing and simplifying the regulatory program.

In response to a Classification Committee draft report released during the developmental stage for this proposed rule, comments letters were received regarding the classification of milk. The comments ranged from suggestions that the entire classification system be revised by providing 2, 4, or 5 classes of milk to suggestions regarding the classification of individual products. Some comments supported the classification method the California state order provides and recommended a review of that method. The comments will be discussed according to each issue.

4a. Fluid Milk Product (§ 1000.15)

The new orders would include a modified *fluid milk product* definition in § 1000.15. The proposed changes to the fluid milk product definition include eliminating the term *filled milk*, including eggnog in the list of specified fluid milk products, and revising the word *buttermilk* to read *cultured buttermilk*. The revised fluid milk product definition would read "any milk products in fluid or frozen form containing less than 9 percent butterfat and more than 6.5% nonfat milk solids that are intended to be used as beverages. Such products include, but are not limited to, milk, skim milk, lowfat milk, milk drinks, eggnog, and cultured buttermilk, including any such beverage products that are flavored, cultured, modified with added nonfat milk solids, sterilized, concentrated (to not more than 50% total milk solids), or reconstituted."

The term "buttermilk," as used in the fluid milk product definition, would be changed to read "cultured buttermilk." The revised term clearly distinguishes the "beverage" buttermilk product from the buttermilk byproduct which is produced from a continuous churning operation.

The fluid milk product definition also would be modified to exclude "filled milk" and to include eggnog in its list of products. Although it is apparent that eggnog is a beverage milk product and clearly meets many of the criteria for being considered a fluid milk product, it is not now included in the list of products identified as fluid milk

products. The proposed addition of eggnog to the list of fluid milk products results in a change of the product's classification from a Class II product to a Class I product. The elimination of the term "filled milk" from the fluid milk product definition is discussed later.

Section 15(b)(1) of the fluid milk product definition would be modified to exclude any product from the fluid milk product definition if the product is a formula especially prepared for infant feeding or a meal replacement without regard to the type of container used to package the product. The reference to "dietary use," which is an imprecise term, would be deleted as a standard for classifying milk products.

At present, "formulas especially prepared for infant feeding or dietary use that are packaged in hermetically sealed containers" are not "fluid milk products" but the exact same formula packaged in a conventional container may be considered to be a fluid milk product if it otherwise meets the standards for such products. This possible difference in classification of these formulas would be eliminated.

The consolidated orders would continue to exclude from the fluid milk product definition formulas designed as "meal replacements" but, as noted above, any reference to "dietary use" should be removed as a classification standard. The words "dietary use" have not been helpful in distinguishing the products that are really beverages from other products that are meant to be much more than just beverages.

As intended for the consolidated orders, the words "meal replacement" would pertain to the type of specialty product that one might find in a hospital or nursing home for people who have a swallowing disability, some type of digestive impairment, or other health or medical problems. Such products include those that are thickened with a thickening agent, such as waxy maize starch, which make them consumable for a person with special dietary needs. Such products do not compete with fluid milk products as a beverage. They are prepared for a limited market and are not sold as milk to the general public.

The term "meal replacement" would not include various types of shake products that are designed for people who are trying to gain or lose weight. Neither would the term apply to products that are advertised as "protein supplements," "instant breakfasts," or "high in fibre." These products clearly may be consumed as beverages and are sold to the general public. Therefore, like other fluid milk products, it is

proposed that they be classified [as Class I.

The meal replacement standard proposed for the consolidated orders is more stringent than the one that is currently applied. At the present time, for instance, products such as "Sportshake," "Powergetic," "Carnation Instant Breakfast," "Resource Dairy Thick," "ReadyCare Thickened Dairy Drink," and "Ultra Slim-Fast" are classified as "meal replacements." As redefined in this proposal, however, only "Resource Dairy Thick," "ReadyCare Thickened Dairy Drink," and similar products would fall within the meaning of "meal replacement," as described above.

Fluid milk products that contain less than 6.5% nonfat milk solids are excluded from the current and proposed fluid milk product definition. Consideration was given to eliminating or lowering this standard because there are some products that resemble fluid milk products but are excluded from the fluid milk product category because their nonfat solids content falls slightly below the 6.5% standard.

Several comment letters were received opposing any adjustment of the 6.5% standard. Some interested parties pointed out that elimination of the 6.5% nonfat milk solids standard would greatly expand the fluid milk product category to include many essentially non-milk products that contain very little milk in them. This could greatly increase market administrator auditing costs in following these products and could regulate several new facilities that would not reasonably be considered to be milk plants. In addition, several dairy product manufacturers argued that their products would be detrimentally affected as other shelf-stable competitive products would gain a substantial economic advantage. The letters stated that the increase in cost associated with the Class I price would force manufacturers to reformulate their products so that no fluid milk or substantially less fluid milk would be used.

After carefully weighing these arguments, it is concluded that any competitive problems that may now exist as a result of the 6.5% standard are very minor and that no change in the standard is warranted at this time.

4b. Fluid Cream Product (§ 1000.16)

No change would be made to the *fluid cream product* definition. The current definition is uniform under all the orders and should be used in the newly merged orders. No comment letters were received which suggested changing the current *fluid cream product* definition;

however, several comments were received in support of the current definition.

4c. Filled Milk

It is proposed that the definition of *filled milk* be eliminated and the term be removed from the fluid milk product definition and other provisions within the orders. Filled milk is a product that contains a combination of nonmilk fat or oil with skim milk (whether fresh, cultured, reconstituted, or modified by the addition of nonfat milk solids). Filled milk was first produced and marketed in the 1960s. In 1968, the orders were amended to provide a definition of filled milk. Currently, there is little or no filled milk being produced under Federal orders. The term filled milk is used 18 times in a milk order. It serves little purpose today except to complicate and lengthen the regulatory language. For this reason, the definition of filled milk would be eliminated and the term removed from the fluid milk product definition and other provisions within the orders.

The form of filled milk and purpose for which it is used are the same as the form and purpose for which whole milk is used. Filled milk is marketed by handlers in the same types of packages and in the same trade channels as whole milk, and is mainly intended to be used as a beverage substitute for milk. Whether made from vegetable fat and fresh or reconstituted skim milk, or any combination thereof, the resulting product resembles whole milk in appearance. Therefore, any filled milk produced and marketed in the future would be classified as a Class I product under the revised fluid milk product definition.

One cooperative association submitted a comment supporting the suggestion to eliminate the definition of filled milk. No comments were received in opposition to this idea.

4d. Commercial Food Processing Establishment (§ 1000.19)

The definition of *commercial food processing establishment* (CFPE) is proposed to be revised by removing the filled milk reference, for the reasons previously discussed, and by removing the word "bulk" from the definition. The removal of the word "bulk" would allow a CFPE to receive fluid milk products and fluid cream products for Class II use in certain sized packages as well as in bulk.

Presently, the CFPE definition prohibits the receipt of fluid milk products for Class II use in relatively small pre-measured packages that might reduce the CFPE's production costs.

Although there were no comment letters directed specifically to this point, this problem has come to the attention of market administrator personnel. While proposing that packaged fluid milk products be permitted to be transferred to a CFPE in any size, it is also proposed that only milk which is shipped in larger-than-consumer-sized packages (i.e., larger than one gallon) should be eligible for a Class II classification. If milk is received in gallon containers or smaller, the milk should be priced as Class I milk since there is no way of guaranteeing that such products will not be sold for fluid use. Permitting milk in any sized container to be sold to a CFPE for Class II use if the container had a special label, such as "for commercial food processing use only," was considered, but such a provision would be impractical and it would be prohibitively expensive for a handler to prepare specially labeled products for small accounts. The current restriction barring a CFPE from having any disposition of fluid milk products other than those in consumer-sized packages (one gallon or less) should be retained under the new orders.

These two restrictions are based upon practical considerations. The integrity of the classified pricing system would be much more difficult to maintain if the market administrator were forced to audit every CFPE on a regular basis. By prohibiting the sale of fluid milk products in consumer-sized packages to a CFPE for anything but Class I use, there would be less need to regularly audit CFPE's to be sure that such products are not being sold to the public. Similarly, since packaged fluid milk products in containers larger than one gallon are rarely, if ever, found in retail outlets, it is unlikely that such products will be sold for fluid use. By restricting fluid milk product disposition by CFPE's to packaged products not larger than one gallon in size, there is reasonable assurance that milk priced as Class II will not be disposed of as fluid milk sold by the glass from a bulk dispenser.

One handler submitted a comment in support of the Committee's suggestions regarding the commercial food processing establishment definition; none were received in opposition to these suggestions.

4e. Classes of Utilization (§ 1000.40)

Historically, the fluid or beverage uses of milk have been classified in the highest-priced class (Class I), and soft or spoonable products, those from which some of the moisture has been removed, have been classified in the intermediate class of milk (Class II). The final

decision issued on February 5, 1993 (58 FR 12634) provided 3 uniform classes of milk for all orders. Classes I and II continued the traditional classification of milk, while the lowest-priced class (Class III) contained the hard, storable products. In a final decision that became effective December 1993, a fourth class—Class III-A (actually a sub-section of Class III)—was established for most orders for milk used to produce nonfat dry milk.

It is recommended that the fluid and beverage uses of milk continue to be the highest-priced class of milk, Class I. Soft or spoonable products, or those used in the manufacture of other food products or sweetened condensed milk, would be classified as Class II products. Class III would contain primarily the hard cheeses, but also such storable products as plain or sweetened evaporated or sweetened condensed milk (or skim milk) in a consumer-type package. Finally, a new Class IV would contain all skim milk and butterfat used to produce butter or any milk product in dried form.

Comments filed regarding the number of classes of utilization for the proposed merged orders varied from supporters of one class, which would eliminate all manufacturing classes, to supporters of 5 classes of milk. Comments concerning the addition of an export class were also received. Some comments urged the immediate suspension or termination of Class III-A, while others recommended a thorough review of Class III-A.

Many commenters suggested that there be one class of milk. A dairy farmer stated that dry milk powder can be used for making cheese or fluid milk and could be easily stored, and later dumped on the market again which could influence the milk price. A large cheese manufacturer maintains that multiple classes of utilization for competing manufactured product uses create market distortion and regulatory adjustments, and argues that a single, market-clearing price for all non-fluid uses would allow competitive forces to determine supply and demand.

Another commenter, also a dairy producer, stated that manufacturing Class II and Class III products is the only means of storing excess milk. According to the producer, at one time much of the country's milk was produced at Grade B standards and, consequently, at a lower cost of production. However, he contends, this is not true today. The producer asserts that the current Federal order system of milk classification is the reason why the dairy industry is not unified and unable to come to a consensus and that milk is

the only commodity in the country that is priced according to its use.

A major dairy foods association suggested that there be two classes of milk (i.e., Class I and all other). However, if multiple classes of milk are maintained, the association proposed that some products be reclassified to Class III and that Class III-A be discontinued. The association also stated that no new milk classifications should be established such as an export class of milk. Another commenter suggested that more than one class of non-fluid utilization of milk is unnecessary and does little to enhance producer income.

A manufacturer of shelf-stable products also supported a two-class system for clarification and simplification reasons, and stated that such a system would also eliminate the need for future hearings to determine the classification of new products. The commenter strongly opposed the reclassification of Class II products in aseptic containers to Class I and argued that these products do not compete with current Class I products, but rather compete in the juice market.

Another handler stated that it supported 3 classes of milk, but stated that many products that are currently in Class III should be reclassified as Class II. The handler contended that classification should be based upon demand elasticity and suggested that the criteria for placing various products into classes should be expanded. Very few products are processed to utilize true surplus supplies of milk, it stated.

A major cooperative association's comment letter supported a 4-class system where Class IV would include butter and nonfat dry milk products, thus serving as the class for market-clearing products. The cooperative stated that a 3-class system would not provide enough differentiation for market clearing. It stated that a distorted market may result when pooled handlers must pay the same prices for milk used in nonfat dry milk as for milk used in cheese. Another cooperative also supported the separate classification for cheese (Class III) and butter and powder (Class IV).

Two trade associations recommended 5 classes of milk for the merged orders. One association recommended that the 5 classes be divided into Classes I, II, III, IVA, and IVB and that products be classified on the basis of product yields. The other association stated that the 5 classes of milk should consist of Classes I, IIA, IIB, IIIA, and IIIB, and that Classes IIA and IIB should be classified on the basis of protein and butterfat, whereas Classes IVA and IVB should be

classified on the basis of solids not-fat and butterfat.

A few comments addressed the issue of an export class. One comment letter supported the concept of continuing to develop export markets and providing for Class III-A or Class IV to compete in the international marketplace. A Missouri dairy farmer wrote that an export class is needed so that the cost of clearing the U.S. market can be shared across Federal order and state order lines.

Another commenter, a dairy products manufacturer, recommended an export class be established for Class I products. The handler stated it is engaged in the packaging and selling of UHT (i.e., ultra high temperature) processed shelf-stable dairy products sold within the United States and abroad. According to the handler, its inability to compete with the price offered by its competitors is the principal reason it has been unable to increase its volume of business in the international market. The handler contends that changes in the Federal order system are needed to allow the American dairy industry to become competitive in the international market.

The handler suggested that the export class price be established just above the Class III level because it would allow milk to flow into either the cheese market or export markets, whichever provides the greater opportunity. The handler claims that the addition of an export-oriented, value-added, product class would yield greater returns to producers than exporting skim or whole milk powder (i.e., currently Class III-A products).

A northwest cooperative association also recommended that consideration be given to establishing an export-oriented class to facilitate the development of export markets and to promote fair trade. Products produced for the world market would be included in a class with a price that reflects "world market" levels. With such a class, according to the cooperative, the dairy industry would be in a better position to promote exports and contribute to the U.S. balance of trade. The commenter contends that processors with exporting potential will benefit from an export class and that producers also will benefit because expanded exports will lead to reduced dairy surpluses.

After careful consideration of the comments and arguments, 4 classes of utilization are proposed for the consolidated orders, as described below. Inclusion of an export class is not proposed because classification is based on form and use without regard to sales area. In addition, it would be difficult to support a concept of dual pricing of a

product—one price for domestic use and a lower price for export. Moreover, to adopt such dual pricing would be inconsistent with the principles of the World Trade Organization.

4f. Class I Milk

Under this proposal, Class I milk would be all skim milk and butterfat contained in milk products that are intended to be consumed in fluid form as beverages. Class I should include all the products included in Class I in the 1993 uniform classification decision plus eggnog.

The 1974 uniform classification decision classified eggnog as a Class II product. The decision recognized that eggnog was prepared to be consumed as a beverage and that it was classified in 9 of the 32 orders as a Class I product. However, the decision stated that eggnog was a highly seasonal product with limited sales. It was also estimated that approximately 40% of the sales of this product was in the form of imitation eggnog. The decision stated that a Class II classification would enhance the competitive position of the product in the marketplace.

In 1991, the recommended decision of the national hearing changed the classification of eggnog from its historical Class II classification to Class I. However, the 1993 final decision for the proceeding reversed the recommended decision classification. The primary reason for the change in the product's Class I classification back to the historical Class II classification was based on exceptions to the recommended decision. At the same time, however, the final decision left low-fat eggnog as a fluid milk product with a Class I classification, as it was prior to the 1990 national hearing.

Class I products are generally classified on the basis of their fluid form and intended use. Eggnog, a highly seasonal product, is clearly intended to be consumed as a beverage. Since this product is manufactured, packaged and distributed to the consumer as a drinkable beverage, it is proposed to be classified as a Class I product. The modest change in the ingredient cost of the finished product should have little or no effect on its sales in the marketplace. Comments received regarding the reclassification of eggnog were generally in support of its reclassification into Class I.

A western producer organization supports the recommendation to include all milk consumed in beverage form in Class I. The organization rejects a two-class system as proposed by processor groups, arguing that such a system makes no economic sense since

not all non-fluid uses of milk are market-clearing in nature and thus should not be placed in the same class. A shift to a two-class system would benefit processors and manufacturers at the expense of producers, according to this commenter.

Class I Used-to-Produce. In order to simplify the accountability for milk products classified as Class I that may contain nonmilk ingredients and/or previously processed and priced skim milk and butterfat, we recommend adding a "used-to-produce" category to Class I. The used-to-produce accountability method would preclude the need to develop and maintain nonstandard conversion factors and non-milk credits (i.e., salt, flavoring, stabilizers) for milk product accountability. This method should improve the accuracy of handler reporting and minimize audit corrections without sacrificing any statistical information, pricing considerations, or classification criteria. No comments were received in response to the recommendation that this category be added to the proposal.

4g. Class II Milk

Most of the products included in Class II as a result of the 1993 uniform classification amendments would continue to be classified as Class II products under the new orders, with 3 exceptions. The exceptions include: (1) Cream cheese, which would be reclassified from a Class III product to a Class II product; (2) eggnog, as discussed already, which would be reclassified as a Class I product; and (3) any fluid product in a hermetically-sealed, all-metal container which would be classified as a Class II product.

The 1993 national hearing decision included cream cheese in Class III. The decision placed spreadable cheeses and cheeses that can be crumbled into separate pieces in Class III, while other more liquid "spoonable" products were placed in Class II. The decision stated that cream cheese is used as a substitute for butter because it functions as a spread and, thus, classified cream cheese in Class III.

The classification of cream cheese should be changed from Class III to Class II. The milk used in Class II products, generally described as "soft" products, is used to process or manufacture products for which handlers know a consumer demand exists. Generally, these products have some of the water removed from producer milk or contain a high enough butterfat content that they will not be used as beverages. Products included in Class II are those that are neither as

perishable as fluid products nor perform a balancing function for the market. Many Class II products have longer shelf-lives than fluid milk products, while being less storable than markets' surplus uses of milk.

The primary distinction between Class II products and the products used to balance the market is existing consumer demand. Although cream cheese may be used as a substitute for butter, it is not made to be stored when no other outlets are available, as is butter. It is a consumer convenience product that is produced to meet consumer demand and not to utilize surplus supplies of milk. Handlers do not process milk into perishable or semi-perishable dairy products if they do not have a consumer market for those products. Accordingly, it is proposed that cream cheese be reclassified from its current Class III classification to Class II.

Three comment letters stated that there is no basis for reclassifying cream cheese into Class II and it should remain with other cheeses in Class III. At least 2 comment letters supported the revised classification of cream cheese. One commenter argued that cream cheese competes for consumer market share with butter, which is currently a Class III product, and should be classified according to its "use" which supersedes any "form" criterion argument. The letter stated that while the reclassification will have no appreciable effect on the blend price, it may be financially detrimental to plants that produce cream cheese.

Some comments addressed the classification of cottage cheese and ricotta cheese, in addition to cream cheese. A national manufacturer of cheese products supports the reclassification of milk used to produce cottage cheese and ricotta cheese from Class II to Class III. The handler states that due to falling demand for cottage cheese, it should be placed with other cheeses in Class III. Another cottage cheese manufacturer made the same suggestion.

These suggestions should not be incorporated in this proposal. Great care should be taken in reclassifying dairy farmers' milk to any class below Class I. Such reclassification may occur when it is necessary to dispose of surplus milk or to allow intermediate dairy products to compete with a nondairy substitute to the benefit of dairy farmers. Neither of these reasons would appear to fit the situation facing milk used in cottage cheese.

The declining market for cottage cheese is likely the result of several factors besides its price. Some of these

factors may be the substitution of newer or improved dairy products for cottage cheese, changing consumer tastes, or consumer preference for lower fat products. There is no indication that reducing the ingredient cost of this product by a fraction of a cent per container would do much to stimulate consumer preference for it.

As discussed above, the phrase in §§ 1000.15(b)(1) and 40(b)(v), "or dietary use (meal replacement)" would be removed and any fluid product packaged in a hermetically-sealed, all-metal container would be reclassified as a Class II product. Formulas especially prepared for infant feeding should continue to be classified as Class II products without regard to the type of container in which they are packaged.

Although no change is intended for the present classification of buttermilk for drinking purposes and buttermilk for baking purposes, some changes are needed to clarify the distinction between the 2 products. First, as noted previously, drinking buttermilk should be labeled as "cultured buttermilk." In addition, some changes are needed to distinguish this product, which is a Class I product, from buttermilk biscuit mix, buttermilk for baking, or simply baking buttermilk, which is a Class II product.

Currently, the criteria used to distinguish drinking buttermilk from buttermilk for baking is that the latter product must contain food starch in excess of 2% of the total solids in the product. However, this criteria is not specified in the orders themselves, but rather in administrative guidelines that have been issued. This guideline should be formalized by stating the standard in the general provisions that will contain the classification section for the consolidated orders. As now specified in Section 1000.40(b)(2)(v), the Class II classification is limited to "buttermilk biscuit mixes and other buttermilk for baking that contain food starch in excess of 2% of the total solids, provided that the product is labeled to indicate the food starch content." It should be emphasized that the proposed standard not only requires buttermilk for baking or buttermilk biscuit mix to contain the required amount of food starch but, in addition, the label must indicate the food starch content of the product.

Class II Used-to-Produce. The 1993 uniform classification amendments changed the accountability method of several products from a disposition basis to a used-to-produce basis. Except for some fluid cream products, all products were moved to the used-to-produce category. The change resulted in simplification and improved

accuracy in the reporting and auditing of these products. This method should be extended to the remaining Class II products that are currently accounted for on a disposition basis, specifically creamers, light cream, milk and cream mixtures, and heavy cream.

4h. Class III and Class III-A (i.e., Class IV) Milk

The July 1993 national hearing decision provided that hard, storable products be included in Class III. Class III-A became effective in 3 Federal orders in November 1992 and was implemented in 27 Federal orders in December 1993. The amendments established a Class III-A milk class that included only nonfat dry milk. It is recommended that the products currently included in Class III continue to be classified in that class with two exceptions. As discussed under the Class II section, the classification of cream cheese should be changed from Class III to Class II. Also, butter and all milk powders that are currently in Class III should be moved to Class IV.

The 1993 Class III-A decision stated that the separate class for milk used to produce nonfat dry milk (NFD) was needed to allow handlers to recover the cost of producing NFD. The Class III-A price is calculated from a product price formula, which provides a make allowance, to arrive at a price for milk used to produce NFD.

There has been a good deal of criticism of Class III-A. Some of the arguments made by critics of III-A are that:

- Class III-A has resulted in lower uniform prices under Federal milk orders;
- A significant amount of milk was not pooled when the Class III-A price exceeded the uniform price adjusted for location;
- The wide gap between the Class II price and the Class III-A price was destroying the market for bulk sweetened condensed milk; and
- The Class III-A pricing system was undermining the Class II and Class III price by allowing milk that is manufactured into NFD at a lower price to be utilized in increasingly large quantities to make soft products and cheese.

Supporters of Class III-A argue that it should be retained for several reasons. One argument that appeared in several letters was the need to remain competitive with butter/powder plants under California's 4a pricing program.

The Pennsylvania Farm Bureau noted that as the dairy industry moves toward the elimination of support prices and more into the international market,

Class III-A pricing will offer a way to capture changing price relationships between cheese, butter, and powder.

Michigan Milk Producers Association (MMPA) and Independent Cooperative Milk Producers Association (ICMPA) argued that the elimination of Class III-A will competitively disadvantage those parties who currently provide market balancing services. They note that as long as California remains outside of the Federal order program, the West Coast nonfat dry milk price, plus a transportation differential, will continue to effectively establish a price ceiling for Midwest nonfat dry milk. This product, according to MMPA and ICMPA, is still a market-clearing product for Michigan, Indiana, Kentucky, and parts of Ohio.

A major Northeast cooperative association, Agri-Mark, also opposed any suggestion to eliminate Class III-A. According to Agri-Mark, arguments that Class III-A pricing has encouraged unneeded nonfat dry milk production are false. Class III-A pricing, in Agri-Mark's view, has allowed nonfat dry milk manufacturers to resume their role of efficiently balancing Class I markets and disposing of reserve supplies. While vigorously supporting the retention of Class III-A pricing, Agri-Mark also stated that it is necessary to modify Class III-A pricing in two primary areas. The first modification involves the replacement of the Central states price with a Class III-A price calculation using a California nonfat dry milk price announced each week. The second modification involves including milk used to manufacture buttermilk powder in the Class III-A definition.

Agri-Mark contends that Class III-A should be continued in all Federal marketing areas in order to allow their nonfat dry milk manufacturing plants to remain competitive with California and therefore be available to balance Class I needs and facilitate the handling of reserve milk supplies in each market. It is also Agri-Mark's view that the current Class III-A pricing formula has worked well and has not given an advantage to nonfat dry milk manufacturers relative to cheese manufacturers.

Agri-Mark acknowledges that the problem of using nonfat dry milk to replace fresh milk in traditional dairy uses when Class III-A prices are significantly below Class II and III prices does exist; however, it argues that the elimination of Class III-A pricing will not alleviate this problem because low-priced nonfat dry milk manufactured in California will still be available to replace local fresh milk. In the absence of Class III-A, local fresh milk may be unable to find a nearby outlet, particularly on a seasonal basis,

resulting in disorderly marketing conditions.

Another commenter, the Alliance of Western Milk Producers (AWMP), stated that separate butter/powder and cheese milk pricing classes would not be detrimental to producers, but rather that a single price class would cause producers economic disaster. The AWMP supports a two-class system for manufactured products. It recommends that Class III include cheese and Class IV include butter, nonfat dry milk, and whole milk powder.

Darigold, a cooperative association based in Seattle, Washington, submitted a comment in support of separate classes for butter/powder (Class III-A) and for cheese (Class III) and offered several arguments why separate classes for butter, powder, and cheese should be adopted. Darigold states that the reconstitution of nonfat dry milk should be viewed as a means to economic efficiency rather than a pricing disruption or distortion. Darigold points out that it is inefficient to have milk transported several hundred miles if cheaper solids could be transported at a lower cost. Darigold also states that reconstitution is actually consistent with the purposes of Federal orders because it promotes the goal of making adequate supplies of milk solids available within a deficit market.

Darigold also states that reconstitution of nonfat dry milk into higher-classed dairy products is much more demand-driven than price-driven and that the increased use of nonfat dry milk in the processing of higher-valued products may be explained by the shortages of milk and continuing declines in milk production that have occurred in some regions, not by price incentives associated with Class III-A. The cooperative also states that milk movements in recent years to the Upper Midwest would have occurred even without Class III-A because milk production was decreasing in the Upper Midwest but growing in the West.

Darigold maintains that concerns about "artificial drying" (i.e., drying milk just to be able to obtain nonfat dry milk solids as a substitute for fresh milk in Class II products) overstate the problem and should be kept in perspective. In addition to acknowledging that such practice would be inconsistent with Federal order program goals, the cooperative points out that it would also be inconsistent with economic efficiency. Darigold states that only a limited amount of nonfat dry milk reconstitution has been driven by a price difference between Class III and III-A sufficient to offset the costs of drying and reconstitution.

Furthermore, it is argued that suggestions to increase the Class III-A price to make it closer to the Class III price is unsound policy. The commenter argues that it makes no economic sense to artificially increase the lowest class price which typically clears the market.³²

Dairyalea, a cooperative association with members in the Northeast, also supports continuation of Class III-A for milk used to produce nonfat dry milk stating that the incorporation of this class allowed for a more equitable sharing of costs among all producers in balancing weekly and seasonal supplies of a market via nonfat dry milk production. While acknowledging that the substitution of nonfat dry milk for fresh milk in Class II and III products decreases producer blend prices, Dairyalea contends that this would continue to occur in the absence of Class III-A pricing because lower-priced powder from California would be available.

Some commenters, while supporting Class III-A, urged the Department to broaden the class to include more products, such as dry whole milk. In addition, several comments were received urging the reclassification of sweetened condensed milk from Class II to Class III or to the same class which includes nonfat dry milk. The commenters explained that sweetened condensed milk is primarily used in commercial food processing establishments and in the confections industry and that it is interchangeable with powdered milk products and sugar in ingredient markets for processed foods and candy. They argued that manufacturers of sweetened condensed milk are currently at a competitive disadvantage with manufacturers of nonfat dry milk. Another commenter also stated that it was losing business because nonfat dry milk is substantially cheaper than fluid dairy ingredients.

A major dairy manufacturer stated that product classifications should not create price discrimination among milk products used for similar purposes. Therefore, it supports the same classification for nonfat dry milk, sweetened condensed milk, and condensed skim milk, which are largely interchangeable. According to the commenter, the current system of classification places sweetened condensed milk at a significant disadvantage and has virtually destroyed the market for sweetened condensed milk. The commenter also

stated that other products that compete with nonfat dry milk, including evaporated milk, should be placed in the same class as nonfat dry.

A great deal of consideration was given to the argument that bulk sweetened condensed milk/skim milk should be reclassified to be in the same class as nonfat dry milk, i.e., Class IV in the proposed new orders. In fact, such a change was recommended in a preliminary Dairy Program Classification Committee report. With the change in class pricing formulas proposed for the new orders, however, the problems leading to this recommendation will be removed. Consequently, bulk sweetened condensed milk and skim milk should remain in Class II.

Bulk sweetened condensed milk/skim milk is used as an intermediate product in ice cream, candy, and other manufactured products. However, these manufactured products can also be made from powdered milk. When powder prices are low relative to the Class II price, there is an economic incentive for powder to be substituted for bulk sweetened condensed milk. As a result, there must be an economic relationship between the Class II price and the cost of using alternative dry or concentrated products to make Class II products. Under current pricing provisions, the Class II price can be excessive relative to using nonfat dry milk since the Class II price is a measure of the value of milk in cheese (the Class III price) plus a differential.

As proposed in this rule, the Class II price for the new orders would be based upon the Class IV price plus a differential of 70 cents. This fixed difference precludes the much wider price differences that have existed at times between Class II and Class III-A prices. Consequently, sweetened condensed milk should continue to be classified as a Class II use.

4i. Shrinkage and Overage

The shrinkage provisions of the new orders should be modified to reflect a pro rata assignment of shrinkage based on handler utilization. In other words, each handler's "shrinkage" or lost milk should be classified according to the handler's use of milk that was not lost in transit or processing. Adoption of such modification will simplify both order language and accounting procedures.

Shrinkage is experienced by handlers in milk processing operations and in the receipt of farm bulk tank milk at receiving stations and processing plants. Milk is unavoidably lost as it remains in pipe lines, adheres to tanker walls and/

³² See Issue Number 3 of this proposed rule for a comprehensive discussion of Class III and IV prices.

or other plant equipment, and is washed away in the cleaning operations. In addition, unexpected losses, including spillage or leaking packages, also contribute to shrinkage.

A shift from the current shrinkage allowance provisions to a pro rata assignment of shrinkage based on utilization would improve market efficiencies, create a more equitable situation among handlers, and facilitate accounting procedures involving shrinkage and overage assignment. Over time, changing conditions within milk markets have led to the adoption of a rather complex shrinkage provision. This provision can be both modified and simplified without compromising the objectives of the Federal milk marketing program. The proposed provision should meet the goals of simplification and improvement of Federal milk marketing orders.

Arguments in support of the proposal illustrate the advantages of a shift to pro rata shrinkage assignment as opposed to either continuation of the current shrinkage class assignment and allocation system or adoption of other alternatives. Several of the major cooperative associations expressed support for the suggestion to prorate shrinkage based on plant utilization. According to one commenter, plants should account to the pool at a price that is the intended use for milk processed at that plant. The commenter added that this will encourage and assure plant efficiency.

Simplification of order language was one of the more frequent comments received in response to the preliminary reports on classification. The shrinkage provision undoubtedly falls within this category. As pointed out earlier, the shrinkage provision has become rather complex. A comment letter submitted by one industry member argues that the retention of the shrinkage provision is unnecessary and that any milk which is not accounted for should be classified as Class I. While this suggestion seems to provide an incentive to inefficient plant operators to minimize the amount of milk loss by placing a higher value on shrinkage than presently exists in the current system, a more equitable method is to assign shrinkage pro rata based on a handler's utilization. This will prevent any handler with solely Class III utilization from being responsible to the pool for shrinkage assigned to Class I.

Other comment letters suggested that shrinkage should be eliminated, along with some other order provisions, because it reduces income to dairy farmers. Some commenters argued that the costs associated with record

keeping, reporting and auditing plant loss has little value to the producer, consumer, or handler. One cooperative association expressed support for the elimination of accounting for animal feed and dumped products; no opposing comments were received.

One handler proposed that shrinkage be assigned all at the lowest classification or all Class I with a monetary credit. The monetary credit would be based on a fixed allowance depending on where the handler's loss is assumed. The handler stated that this would eliminate a substantial number of words from the order language. This handler also suggested expanding the shrinkage rules to allow for aseptic packaging because shrinkage in aseptic packaging is far greater than in a plant processing milk in containers, according to the handler. The handler suggested a 4% shrinkage allowance for aseptic packaging.

In Section 30 of each order, pool plant operators and certain other handlers are required to report their total receipts and disposition of skim milk and butterfat. In Section 40, the total reported receipts are classified according to usage. Any positive difference between receipts and utilization is referred to as *shrinkage* and any negative difference is called *overage*. The proposed orders would provide that for each pool plant and each cooperative association bulk tank handler, the market administrator would determine the shrinkage or overage by subtracting the handler's utilization of milk from its receipts of milk, and then prorate the shrinkage to the respective quantities of skim milk and butterfat in each class by using the handler's total reported utilization. In contrast to the current lengthy provision for assigning shrinkage, the new shrinkage provision would remove the necessity for computing shrinkage allowances on various sources of receipts.

Currently, the shrinkage provision maintains allowances for various sources of receipts. Milk that a handler receives at its plant on the basis of weights determined from its measurement at the farm and butterfat tests determined from bulk tank samples (farm weights and test) receives a 2 percent allowance to be classified as Class III. If the handler receives milk on other than farm weights and tests from a cooperative bulk tank handler or another pool plant, a 1.5 percent allowance is given to the receiving handler and a 0.5 percent shrinkage allowance is given to the bulk tank handler or other pool plant selling the milk. Any shrinkage assigned to pooled

milk is assigned to Class III up to this allowance.

If a handler receives fluid *other source milk*, it receives a pro rata share of the total loss which is assigned to Class III without limit. Any shrinkage exceeding the total of these two assignments is assigned to Class I.

When comparing the dairy industry to other industries, there is a difference in how waste, or shrinkage, is handled. A non-dairy manufacturing plant has a certain amount of waste, and it pays the same for wasted material as that going into the product made. It does not pay less or assign a lower value for the "shrinkage" as is done in the dairy industry. Although some may argue that shrinkage should be assigned to the lowest class because handlers receive no return on milk losses experienced in the receiving and processing operations, a pro rata assignment should result in handlers' limiting milk loss throughout the dairy process. In a bottling plant, shrinkage would be assigned to Class I in a larger proportion than the current method. This would have the effect of creating more costs for a Class I handler. In other words, placing a higher value on shrinkage by having milk assigned pro rata to all classes, as is recommended, would encourage a handler to reduce costs associated with shrinkage, resulting in more efficient dairy operations. Also, as proposed here, shrinkage would be assigned to Class II for the first time. This would also encourage less shrinkage, hence, greater efficiency.

Pro-rata shrinkage assignment would more closely reflect the nature of the plant's operation. If milk is to be classified on the basis of form and use, it would appear logical that any loss associated with a particular use should be classified the same as the usage. If a handler has a high Class I utilization, it seems appropriate that the same utilization percentage would apply to its loss/shrinkage. A handler with a multi-class operation would have shrinkage prorated to all classes of utilization based on the percentage used in each class. If a handler has only Class III utilization, all shrinkage would be assigned to Class III.

In doing its cost accounting for Class I fluid milk, a handler would have to factor in the extra cost for shrinkage as part of its calculations. The handler would feel secure knowing that its competition is going to have the same method of prorating shrinkage applied to its operation. The benefit of greater uniformity is apparent. Class I handlers would have a greater incentive to operate more efficiently if they are to account for milk lost at the higher class

value; hence, greater consideration would be given to minimizing shrinkage to reduce costs.

The additional money paid into the pool by handlers operating pool distributing plants with high Class I utilization would not be offset by a lesser amount paid into the pool by handlers operating plants that manufacture primarily Class II and III products. Therefore, the blend price to producers would be enhanced by this change in the shrinkage rules, but it is estimated that it would be less than an average of one cent per cwt.

Historically, overage has been allocated pursuant to Section 44 (Classification of producer milk) starting with Class III. Since shrinkage would be assigned pro rata based on the utilization in each class, it would appear logical to assign overage on the same basis. Utilization would be adjusted to arrive at gross utilization. The references to overage and shrinkage would be removed from Section 44. In computing a handler's value of milk, the method of pricing overage in Section 60(b) would not change. However, the reference to Sections 44(a)(14) and 44(b) would be replaced with Section 43. Also, as explained under the discussion of "General classification rules," Section 41 would be removed entirely and the remaining shrinkage provision would be incorporated in Section 43.

There would be minimal impact on the blend price by assigning overage before allocation begins rather than in the current step 14 of Section 44. The total value of milk classified plus the overage value would be the same using either method. However, if a handler had receipts from an unregulated supply plant or a plant regulated under another Federal order, the assignment of such receipts may be slightly different than the current assignment method.

Animal feed and dumped products should be removed from Class III in Section 40 and included in shrinkage. This would place less of a regulatory burden on handlers who are required to file reports regarding these types of disposition. It would also simplify market administrator auditing procedures considerably.

The suggestion to include a dollar credit at the difference between Class III and Class I prices for unaccounted milk was also considered. This alternative would result in additional time and resource allocation, and would not simplify the orders, but rather complicate them.

4j. Classification of Transfers and Diversions (§ 1000.42)

Certain changes should be made to the classification of transfers and diversions section of the orders to simplify and clarify order language. At the present time, in many orders if any milk that is diverted from one order to another for requested Class II or III use is assigned to Class I, the dairy farmer who shipped that milk is defined as a producer under the order receiving the milk with respect to that portion of the milk assigned to Class I. In other orders under similar conditions, the dairy farmer becomes a producer on the receiving order for all of the milk diverted even though only a portion of the milk was classified as Class I. When this type of adjustment is necessary, the diverting handler is informed by the market administrator's office that there is not enough Class II or III use remaining in the receiving plant to absorb all of the milk diverted. In such case, the diverting handler may pick which load or loads of diverted milk will become producer milk under the receiving order.

Since the orders are not precisely clear on how inter-order diverted milk should be handled, some modification is needed in the order language. Under most orders, and as provided in this proposed rule, milk may be diverted from one order to another for a requested use other than Class I. However, if there is not enough Class II, III, or IV utilization in the receiving plant to be assigned to the diverted milk, some milk may have to be assigned to Class I. When this happens, the practical administrative problems involve determining which milk of which dairy farmers and which loads of milk will be shifted as producer milk from one order to another.

Market administrators should be given some flexibility to handle these administrative problems on a market-by-market and case-by-case basis. As a practical matter, most milk diverted between orders is diverted by cooperative associations that reblend proceeds to their members. In most cases, it makes little difference to a cooperative association whether a dairy farmer is a producer on one order or another order; any differences in blend prices between the orders will be washed out in the reblending process. In the case of nonmember producers diverted inter-order, however, differences could arise in a producer's net proceeds for the month depending upon how much milk was pooled in each order. Therefore, these situations should be handled in such a way as to

be least disruptive to individual dairy farmers.

A market administrator does not know until handlers' reports have been received that some portion of milk reported as diverted to another order cannot be absorbed by the amount of non-Class I utilization in the receiving order's plant. In such case, the diverting handler should be given the option of designating the entire load of diverted milk as producer milk at the plant physically receiving the milk. Alternatively, if the diverting handler wishes, it may designate which dairy farmers on the diverted load of milk will be designated as producers under the order physically receiving the milk. As a last resort, the market administrator would prorate the portion of diverted milk among all the dairy farmers whose milk was received from the diverting handler on the last day of the month, then the second-to-last day, and continuing in that fashion until the diverted milk that is in excess of Class II, III, and IV use has been assigned as producer milk under the receiving order.

A conforming change that should be made in each order relates to milk that is transferred or diverted for Class II or III use. Presently, milk may be transferred or diverted on a requested Class II or III basis. However, with 4 classes of utilization recommended for the new orders, milk could be diverted for requested Class IV use also. Rather than specifying "Class II, III, or IV," however, the orders should simply state "other than Class I" to accommodate a system of more than 3 classes. This language is simpler, shorter, and accomplishes the same end.

Comments received from interested parties involving transfers and diversions suggested general simplification and clarification of order language, as well as some suggestions on how to facilitate the administration of these provisions. Generally, the comment letters suggest that the orders be amended so that inter-market transfers are allocated to Class I in the same manner as transfers within markets. These letters state that, otherwise, a barrier to the movement of milk is created. It was argued that such modification would help to assure distributing plants an adequate supply of milk for fluid use whenever and wherever it is needed. Other comments argued that if a shipment between orders is designated as Class I, it is only logical and fair that the entire shipment should be Class I, rather than be subject to current pro rata allocation procedures. Proponents of this view argued that this would lead to a more

equitable situation in the treatment of inter- and intra-order transfers, allow for greater equity among handlers, and contribute to the simplification and reduction of administrative procedure and cost.

A cooperative association and a handler filed comments endorsing a preliminary suggestion of allowing milk to be diverted inter-order for any use, but a dairy farmer association submitted one comment critical of the idea. The association which opposed the idea implied that milk received on a diverted basis from another order would get a priority Class I assignment over local producer milk. This was not the intention behind this suggestion. Any milk that was diverted from one market to another would have been assigned based upon the lower of the receiving plant's Class I utilization or the receiving market's Class I utilization. In view of the concern about the possible impact of permitting milk to be diverted for any use between orders, no change in this regard is proposed for the consolidated orders.

Inter-order transfers would continue to be allocated based on the lower of the receiving plant's or receiving market's utilization rate. Preference should not be given to such other order bulk milk in the manner suggested by various commenters. Even within markets with high Class I utilization rates, there are times when milk is used in surplus products, and classified as other than Class I. There is no reason why milk from an other order should be classified as completely Class I when local milk inevitably is classified other than Class I. Both types of receipts should share equally in the Class I and surplus utilization.

In § 1000.42(d)(2)(i), the phrase, "excluding the milk equivalent of both nonfat milk solids and concentrated milk used in the plant during the month," is proposed to be added to this sub-paragraph to more directly arrive at transfer and diversion classification on the basis of the assignment of a nonpool plant's utilization to its receipts. The recommended modification will prevent unnecessary accounting steps which serve no purpose in verifying the utilization at the nonpool plant. In classifying receipts of fluid milk and cream products at nonpool plants from Federal order plants, an accounting balance function serves no purpose.

In § 1000.42(d)(2)(vi), the allocation process for bulk fluid milk transferred from pool plants to nonpool plants is proposed to be modified such that any remaining unassigned receipts of bulk fluid products be assigned, pro rata among such plants, to the extent

possible first to any remaining Class I utilization and then to all other utilization, in sequence beginning with the lowest class at the nonpool plant. This change returns the order language to the assignment sequence that was adopted in the Uniform Classification Decision of 1974. Receipts from pool plants should not be given preference by assigning such milk to the available Class II use before assigning receipts from dairy farmers who constitute the regular source of milk for such nonpool plant. Generally, milk transferred or diverted from pool plants to nonpool plants is surplus milk and would be used in storable manufactured products, such as nonfat dry milk and butter. By assigning transferred or diverted milk to a nonpool plant's Class II utilization first, the pool plant operator is forced to account for this milk at the Class II price, even though the nonfat dry milk or other surplus product that was made with the milk is of a lesser value. This process will prevent the assignment of receipts at a higher utilization than the actual utilization.

Receipts of bulk fluid cream products at nonpool plants from pool plants and plants regulated under other Federal orders, similarly, would be assigned to the lowest class utilization first. Generally, a plant operator will use its regular source of supply in the highest valued uses before using alternative supplies. Thus, if a nonpool plant receives cream from a pool plant or a plant regulated under another Federal order, it is likely that the regulated plants were trying to dispose of their excess cream. The nonpool plant receiving the cream will most likely use it for manufacturing purposes; therefore, it should be assigned to the lowest class first. The priority given to regular source supplies is recognized and the provision modified to reflect this.

4k. General Classification Rules (§ 1000.43)

For classification purposes, the milk of a cooperative bulk tank handler—i.e., "a 9(c) handler"—should be treated as "producer milk" of a pool plant operator. This change will shorten and simplify the allocation section. Accordingly, paragraph (a) of Section 43, as revised, no longer contains a reference to the classification of producer milk with respect to a handler described in Section 9(c).

The computation and classification of shrinkage and overage have been added to this section. This will eliminate Section 41, the section previously used for this purpose. Also, the last paragraph of Section 43 should be removed because milk for Class IV use

now would be classified in Section 44 of the orders.

4l. Classification of Producer Milk (§ 1000.44)

A handler may receive milk from a producer, a cooperative association acting as a handler on bulk tank milk, by transfer from another pool plant, or from "other sources" such as nonpool plants, partially regulated plants, and plants that are regulated under other orders. Because of this diversity in sources of receipt, it is necessary in a milk order to go through an allocation sequence to determine which source of milk gets priority to a particular class of utilization and to determine how producer milk was used. In some orders, this allocation sequence is done on a system-wide basis; in others, it is done for each plant receiving producer milk.

Section 44 is one of the most complicated and difficult-to-understand sections in a milk order. Consequently, an attempt has been made to simplify and shorten it. Part of this task was made easier by proposed changes to other sections (e.g., elimination of filled milk, elimination of individual handler pools, and modification of the treatment of inter-order transfers and diversions). Also, because shrinkage and overage are prorated to a handler's gross utilization, these items do not have to be allocated.

All orders are not now uniform in the classification of producer milk. For example, some orders (e.g., Chicago Regional) provide for system allocation while others allocate receipts on a plant-by-plant basis for a multiple plant handler.

Under the consolidated orders, milk would be allocated on a plant-by-plant basis, as modified to reflect the other changes proposed herein. The system allocation method that is found in some orders is based upon a set of marketing conditions concerning the locations of handlers' plants and the market's available milk supply in relation to those plants. These provisions were intended to stop abuses that occurred when milk was imported from one market to another. Rather than permit an inter-order transfer to be assigned at a handler's high Class I utilization plant, while the handler's producer milk was assigned to lower use value at another of its plants, the system allocation provisions assigned the transfers on the basis of the handler's utilization at all plants combined. The objective was to prevent more distant other order milk from being assigned to Class I use at the expense of producers who were located nearer to the city markets and who represented the normal source of supply for the markets' fluid milk needs.

The 11 new orders proposed here do not fit within the parameters of the classical model where a major consumption area is surrounded by production areas. The marketing areas proposed for the consolidated orders span several states and have a number of major population centers. They also have pockets of milk production that, in a number of cases, are in higher-priced areas than some of the fluid milk plants within the marketing area. This milk may not be economically available to a fluid milk plant several hundred miles away. In fact, it may be that a plant near the periphery of a multi-state market may find its closest and cheapest source of supply from outside the market rather than from within the marketing area. Accordingly, the foundation on which the system allocation rules are based does not support current marketing conditions. Therefore, all orders are proposed to be modified to allocate milk only on a plant-by-plant basis rather than on a system basis.

Another change that should be made in the allocation section concerns the "98/2" rule. At the present time, only 98 percent of the packaged fluid milk products transferred between orders is allocated to Class I; the remaining 2 percent is allocated to Class III. This provision, originating from the June 19, 1964, "compensatory payment" decision, was adopted to provide an allowance for "route returns." According to that decision, "it is reasonable to expect some route returns will be associated with inter-market transfers just as there are in connection with milk locally processed in the receiving market * * * a small allowance of 2 percent for such returns, which must fall into surplus use, should be included to avoid such over-assignment in Class I." (29 FR 9120).

The 2 percent Class III allowance on inter-market packaged transfers would be eliminated. As explained above in connection with the proposed changes to the shrinkage provisions, animal feed and dumped products would no longer receive an automatic Class III classification, but instead would be treated as shrinkage and prorated to the plant's utilization. Similarly, inter-order packaged transfers would no longer receive an automatic Class III classification for 2 percent of those transfers but instead should be allocated 100 percent to Class I utilization.

In § 1000.44(a)(3)(iv), some new language to most, but not all, orders is proposed to be added to make it clear that any fluid milk products received by a regulated handler from a producer-handler will be assigned to the receiving handler's lowest utilization available

whether such products are physically received at the regulated handler's plant or whether they are "acquired for distribution" at some other location. The additional words, "acquired for distribution," would clarify the application of this provision in those orders that do not now contain this language.

A key basis for exempting producer-handlers from regulation rests on the presumption that producer-handlers will be responsible for disposing of their surplus milk. This is why milk received from a producer-handler is down-allocated to the lowest possible utilization. If this were not done, a producer-handler could undercut the minimum order Class I price by selling its surplus milk to regulated handlers for fluid use.

In some isolated cases, producer-handlers have avoided lowest-class pricing of their surplus milk by selling their packaged fluid milk products to regulated handlers at a non-plant location, such as a warehouse, from which it is then distributed on routes by the regulated handler. Under some orders, this milk would not be considered a receipt from a producer-handler and thus would not be priced. As proposed herein, however, such fluid milk products that are acquired at the non-plant location will nevertheless be treated as if they had been received at the regulated handler's plant and will be priced accordingly.

In addition to the changes discussed above, Section 44 is proposed to be shortened and simplified by removing unnecessary references that serve to confuse the language rather than make it easier to understand. Where possible, simpler language has been used to replace lengthy section references.

4m. Conforming Changes to Other Sections (§§ _____ .14, _____ .41, and _____ .60)

Paragraph (b) of § _____ .14 should be removed to reflect the fact that all packaged fluid cream products now would be accounted for on a used-to-produce basis. Also, as previously noted, the simpler and shorter treatment for shrinkage shortens the existing provision to the point where it is no longer necessary to keep a separate section for it. Therefore, Section 41 should be eliminated and the revised contents of that section should be incorporated as a new paragraph (b) in Section 43. Finally, conforming changes should be made to Section 60 (Handler's value of milk for computing the uniform price) to reflect the elimination of filled milk from the order, and to reflect changes in references due to other

modifications such as the changes in the treatment of shrinkage and overage.

4n. Organic Milk

During the development stage of the order reform process, a proposal was received from Horizon Foods to exempt organic milk from pricing and pooling under Federal milk orders.

In 1990, Congress passed, and the President signed into law, the *Organic Food Production Act of 1990* (7 U.S.C. 6501 *et seq.*), establishing the first Federal standards for organic food products. A proposed rule was issued on December 5, 1997, and published in the **Federal Register** on December 16, 1997 (62 FR 65849), to implement the National Organic Program.

Organic dairy products can now be found in many, if not most, major grocery chains in metropolitan areas. The retail price of organic dairy products is well above non-organic products. For example, in one Washington-area supermarket a half-gallon of regular 1% milk sells for \$1.59, while a half-gallon of Horizon Organic 1% milk sells for \$2.29. In addition to carrying organic milk, many supermarkets now also carry organic yogurt, sour cream, butter, and other organic dairy products. All of these products are priced well above their non-organic counterparts.

Processors of organic milk have asked for exemption from Federal regulation. In a May 20 letter to the Department, Horizon Foods argued that (1) organic milk is a different commodity; (2) the market for organic dairy products is a niche market; and (3) Federal order regulation of organic milk is contrary to the intent of the Organic Foods Production Act because it does not "facilitate interstate commerce in fresh and processed food that is organically produced." Horizon's proposed solution is to exempt organic milk from the producer milk definition if the milk is produced on a certified organic farm and if the broker pays the producer at least 110% of the month's Class I price for such milk.

The proposal to exempt organic milk from Federal order pricing should be denied for several reasons. First, contrary to the assertions of Horizon Foods that all organic milk is priced at 110% of the Class I price, regardless of how the milk is used, there is evidence that some organic milk is pooled and priced as non-organic milk under some orders, including the Chicago Regional and Southern Michigan orders, for example. Second, if special treatment is provided for organic milk, a "Pandora's box" would be opened for special treatment for other kinds of milk as

well. Third, although the retail price of organic milk is well above non-organic milk, many people believe that organic milk competes with the regulated market and, therefore, also must be fully regulated. Fourth, if Congress wished to exempt organic milk from Federal milk order regulation, they could have done so either in the Organic Foods Production Act or in the 1996 Federal Agricultural Improvement and Reform Act; but they did not. Fifth, there is no indication that all processors of organic milk price their receipts the same way as Horizon Foods. Even if they did, however, the one class/one price system currently used by Horizon could be a temporary phenomenon due to the rapidly expanding market for organic products. The day may come when the organic market becomes saturated and milk in excess of fluid needs must be disposed at competitive prices. If and when this happens, it is likely that some form of classified pricing will be implemented. Finally, the Act provides for classifying and pricing milk on the basis of its form and use. As a result, different costs that may be associated with producing organic milk or other types of milk are not relevant. For these reasons, it would be inappropriate at this time to exempt organic milk from pooling or to provide any other type of special treatment for it under the guise of Federal order reform.

4o. Allocation of Location Adjustment Credits

A provision that is now common to most orders is not suggested for the proposed consolidated orders. This provision, which allocates location adjustment credits that are applied to transfers of bulk fluid milk products between pool plants, is commonly found in Section 52 of most current orders (See, for example, §§ 1001.53(h), 1007.52(b), 1030.52(c), or 1079.52(d)).

Under most orders, intra market shipments of milk between handlers are assigned to Class I use, unless both handlers agree on a lower classification. Milk that is assigned to Class I use is priced at the receiving plant subject to a location adjustment credit that may apply if it is demonstrated that such milk is actually needed for Class I use. If the credit is applied, the milk is priced at the transferring plant. This assignment of location adjustment credits is intended to prevent the use of pool proceeds to pay the hauling cost for the transfer of bulk milk between pool plants when the intended use of the milk is for other than Class I use.

To carry out this concept, the provision typically assigns a pool distributing plant's Class I use first to its

milk receipts directly from producers, then to bulk milk received from a cooperative bulk tank handler, then to milk received by diversion from another pool plant, and then to packaged fluid milk products received from other pool plants. The remaining Class I use in the distributing plant is then assigned to bulk milk received by transfer from other pool plants. In some orders, this remaining Class I use is assigned pro rata to all of the pool plants from which bulk milk was obtained. In other orders, the remaining Class I milk is first assigned to pool plants with the same Class I price and then, in sequence, to pool plants with progressively lower Class I prices.

This provision has varying usage in orders today. Some orders use it; but most orders never use it. Accordingly, it is not clear whether it should be included in the consolidated orders.

This proposed rule is based on the premise that Class I milk does not have the same value at every location. For this reason, Class I differentials have been established for each order with location adjustments that result in establishing a unified Class I price structure that applies to every county and city in the contiguous 48 states. Given this approach, it may no longer be necessary to classify a bulk movement of milk as Class I milk in one section of the order and then in another section of the order depart from the principle of pricing such Class I milk at the plant where it was physically received.

Some of the proposed orders have transportation credit provisions that provide for hauling credits on bulk milk received by transfer from a plant regulated under another Federal order and assigned to Class I use at the receiving plant. To arrive at the classification of such milk, the milk is assigned to the lower of the receiving plant's or the receiving market's Class I utilization. With the long distances exhibited by milk movements today and the use of transportation credit provisions that help defray the costs for such movements, it may not be appropriate to continue location adjustment credit provisions that could discourage milk from being transferred from pool plants located closer to distributing plants needing supplemental supplies of milk.

In actual practice, a distributing plant does not receive a fixed amount of milk each day of the week. Some days are heavy bottling days when more milk is needed for Class I use. On such days, a distributing plant may not be able to obtain enough local milk to meet its Class I needs and may have to import plant milk from more distant locations.

At the end of the month, however, when the allocation of location adjustment credits takes place, it may appear that there was more than enough local milk to meet the distributing plant's fluid needs, even though this was not the case when recapped on a daily basis. Nevertheless, the allocation provision allocates location adjustment credits based on monthly volumes of milk, not daily volumes, so the supply plant could be in a position where it receives no Class I location adjustment credit even though the milk was indeed shipped for Class I use.

Finally, the current application of the provision in question can result in a situation where there is more incentive to receive bulk milk transferred from a plant regulated under another Federal order than from a plant regulated under the same order, whether or not any other transportation credits are involved. Should this occur, it can result in a transfer of Class I sales to the transferring plant's Federal order market.

5. Provisions Applicable to All Orders

In addition to the terms and conditions of milk orders previously described, there are a number of other provisions that need to be contained in milk orders that describe and define those affected by the regulatory plan of the program and that provide for common descriptions of entities, persons, terms of measurement, pooling, and other administrative needs so that an order can be administered effectively. Many of these provisions can be uniform across all proposed consolidated orders. However, different marketing conditions in the consolidated areas, together with institutional factors, do not lend themselves to an entirely uniform set of provisions for all orders. Consequently, in each of the proposed consolidated orders there are provisions that are unique to each order.

As part of the reform process, an Identical Provisions Committee (IPC) was established to investigate and recommend needed order provisions that could be uniformly applied across the consolidated system of Federal milk orders. The IPC was formed with a three point purpose: to develop Federal order provisions that can or should be uniform among orders, to explain why the adoption of the recommended provisions are needed, and to simplify and streamline proposed order provisions where feasible. While the previously discussed issues such as classification, the basic formula price, and Class I milk pricing lend themselves to uniform applicability across all

orders, the IPC mission tended to focus on other aspects of milk order provisions such as uniform definitions, pooling criteria, reporting requirements and handler payment obligations.

This part of the proposed rule discusses the nature of the proposed consolidated order provisions, explains why they are needed, and details whether or not a provision can be uniformly applied in all consolidated orders. When a provision does not lend itself to uniform application, the provision is described in subsequent sections of this proposed rule where the provisions unique to each of the individual orders are discussed.

To the extent that provisions can be uniformly applicable across all of the proposed consolidated orders, they are included in Part 1000, the General Provisions of Federal Milk Marketing Orders which are, by reference, already a part of each milk order. Thus, as proposed here, the General Provisions includes the definitions of *route disposition, plant, distributing plant, supply plant, nonpool plant, handler, other source milk, fluid milk product, fluid cream product, cooperative association, and commercial food processing establishment*. In addition, the General Provisions include the milk classification section of the order, pricing provisions, and most of the provisions relating to payments. These additions to the General Provisions should make milk order provisions more understandable to the general public by removing the differences that now exist and by consolidating uniform provisions in one place. Thus, an interested person would only have to read one "nonpool plant" section, for instance, to understand how that term is applied to all orders. By contrast, at the present time, "nonpool plant" is defined in every order and there are slight differences in the definition from one order to the next.

Pooling Issues

How producers share in the additional revenue that is derived from classified pricing is one of the most important features of a milk marketing order. How milk is pooled sets the basis for returning a blend price to producers by accounting for the use-value, or classified value, of milk charged to handlers. Marketwide pooling is the method advocated for distributing these returns as indicated by an overwhelming majority of public participants. It is the prevailing method employed in the current system of milk orders, and should continue to be employed in the consolidated orders.

There were a number of proposals and public comments considered in determining how Federal milk orders should pool milk and which producers would be eligible to have their milk pooled in the consolidated orders. In the broadest sense, most public comments and proposals advocated a policy of liberal pooling, thereby allowing the greatest number of dairy farmers the ability to share in the economic benefits that arise from the classified pricing of milk. While there were also a number of public comments supporting identical pooling provisions in all orders, other proposals voiced comments on the need to have pooling provisions reflect the unique and prevailing supply and demand conditions in each marketing area. Fundamental to most pooling proposals and comments was the notion that the pooling of producer milk should be *performance oriented* in meeting the needs of the fluid market. The pooling provisions proposed for the consolidated orders provide a balance between reasonable and needed performance criteria and a liberal pooling policy.

The pooling provisions for the consolidated orders are overall less restrictive in the movement of milk between orders and make it easier for producers to become associated with and pooled on a market. Additionally, the provisions are more "market oriented" because they allow milk to become pooled and priced where the greatest needs are exhibited for satisfying fluid demands. Additionally, there is enhanced flexibility in how plants can be pooled without diminishing the ability of the regulatory plan to satisfy the fluid demands of a market. For example, this decision recognizes that in some markets, fluid milk processors handle a significant volume of milk for Class II uses. Much of the time this milk may be processed in a separate processing plant. To accommodate this, *unit pooling* is an option if at least one plant of the unit qualified as a pool distributing plant and the other plants of the pool unit are located in the marketing area and process only Class I or Class II products. The separate processing plant would also need to be located in the same or lower price zone than the qualifying pool distributing plant. For supply plants, *system pooling* offers flexibility where handlers operate more than one supply plant. Further, the consolidated orders have identical performance requirements for pooling cooperative and proprietary handlers alike, thereby making plant ownership irrelevant for pooling purposes.

Pool plant eligibility continues to be dependent upon plant operators and handlers meeting certain performance standards geared to satisfying the fluid demands of the market. Because of differences between the consolidated markets, mainly the level of Class I demand and the seasonality of milk production, a uniform standard for pool plants for the consolidated markets is not recommended. Such standards need to be specific to each of the consolidated orders. Additionally, the market administrator should be authorized to react to changing market conditions if there is a need to change performance standards and to promote the efficient movement of milk and in satisfying expected demands of the fluid market. These needs are reflected and accommodated in the definitions of the types of pool supply plants in the consolidated orders. Providing for differences between markets ensures more equitable distribution of the benefits and burdens of marketwide pooling.

Taken as a whole, the pooling provisions also are designed to properly specify which producers are associated with the marketwide pool, thereby assuring their ability to share in the economic benefits that accrue from classified pricing. Orders do require some criteria for determining when a producer has an association with a market under which their milk will be pooled and priced. In this context, a minimal "touch-base" requirement for producer milk is called for in most consolidated orders for pooling qualification. This provision allows a producer's milk to be received at a pool plant a minimum number of times to be eligible for diversion to nonpool plants thereby ensuring that the milk is available for fluid use if needed.

The producer and producer milk provisions for the consolidated orders also recognize that disorderly marketing conditions can arise from the actions of handlers that seek to pool milk on an order only when more favorable alternatives are not otherwise available. Reasonable measures are provided to prevent producers who are not regularly a part of a marketwide pool from deriving the benefits of the marketwide pool if certain performance criteria are not met. Similarly, it is recognized that producer milk might not be pooled because of changes in class-price relationships in any given month. Public comments and proposals offered to address these issues included "lock-in" or "lock-out" provisions that, as proposed, would have the effect of regulating producers. They are not recommended. The provisions

presented for both the producer and producer milk definitions provide reasonable measures and safeguards for determining conditions where producers and their milk should participate in a marketwide pool without causing producers to become regulated in their capacity as producers.

A suggestion for "open pooling," where milk can be pooled anywhere, is not provided for in the consolidated orders. There are two reasons for this. First, open pooling is not based on performance, that is, open pooling provides no reasonable assurance that milk will be made available in satisfying the fluid demand of a market. Second, advocates of open pooling have presented this pooling option in the context of a "package" of other order provisions, including Class I pricing, that conflict with the method of Class I pricing recommended in this decision. For this reason open pooling is unworkable. For this reason also, proposals to create and fund "stand-by" pools are similarly rejected.

Where a handler's plants are regulated continues to be based primarily on the basis of where sales are made, rather than where plants are physically located, with only minor exceptions. The change in where a distributing plant will be regulated will require a reasonable measure of at least three consecutive months of more sales in another market area before the regulatory status of a plant and producer milk associated with the plant will shift to another milk order. Supply plants will be regulated under the order in which the greatest portion of its qualifying shipments have been made.

The proposed definition of an exempt plant recognizes that some handler operations are too small to have a significant impact on the competitive relationship of competing fluid processors in the market. In recognition of this, the amount of milk for an exempt plant has been liberalized without references to daily average deliveries criteria that are currently applicable in some orders.

Route Disposition

Route disposition is a measurement of sales used to determine a distributing plant's association with a marketing area. It is defined to mean the amount of milk delivered by a distributing plant to a retail or wholesale outlet (except a plant), either directly or through any distribution facility (including disposition from a plant store, vendor or vending machine), of a fluid milk product in consumer-type packages or dispenser units that is classified as Class I milk.

The recommended route disposition definition differs from the definition contained in some current orders. Presently, the route disposition definition of several orders makes reference to plant movements of packaged fluid milk products between distributing plants with respect to determining if such transfers should be considered "route disposition" of the transferring or receiving plant. As proposed here, however, this issue is addressed in the pool plant section, which deals with the pooling standards applicable to a distributing plant.

Plant

A plant definition is included in all orders to specify what constitutes an operating entity for pricing and regulatory purposes. As provided in § 1000.4 of the General Provisions, a *plant* is the land, buildings, facilities, and equipment constituting a single operating unit or establishment at which milk or milk products are received, processed, or packaged. This is meant to encompass all departments, including those where milk products are stored, such as a cooler. The plant definition does not include a physically separate facility without stationary storage tanks that is used only as a reload point for transferring bulk milk from one tank to another, or a physically separate facility that is used only as a distribution point for storing packaged fluid milk products in transit for route disposition.

To account for regional differences and practices in transporting milk, some orders provide for the use of reload points for transporting bulk milk that do not have stationary storage tanks.

Farm-Separated Milk

With the advent of new technology for on-farm separation of milk into its components, some additional regulatory language is needed to specify who is the responsible handler for the milk or milk components leaving the farm and how these components will be classified and priced. This determination will be based, in part, on whether the farm processing facility is a plant.

Ultrafiltration (UF) is a membrane process that transfers water and low-molecular weight compounds through a membrane while retaining suspended solids, colloids, and large organic molecules. It selectively fractionates some milk solids components and selectively concentrates other solids components of milk.

When a UF membrane is used, water, lactose, uncomplexed minerals and other low-molecular-weight organic compounds pass through the membrane. For example, if unaltered milk

containing 3.5 percent fat, 3.1 percent protein, and 4.9 percent lactose is run through a UF membrane until half of the original volume is eliminated, the remaining product not passing through the membrane (i.e., *retentate*) will contain all of the fat and protein but only half of the lactose. The *permeate* (i.e., that part of the original milk that does pass through the membrane) will contain water, lactose, non-protein nitrogen, and about one-sixth of the minerals.

Reverse osmosis (RO) is also a membrane process, but the membranes have much smaller pores than UF membranes, allowing only the water to pass through. The end product essentially is concentrated milk.

At the present time, both reverse osmosis and ultrafiltration systems are being utilized on some farms, principally large farms in the southwestern United States. The product shipped from these farms (i.e., the *retentate*) currently is sent to processing plants for use in manufactured products but it could be used in a range of milk products.

The retentate received from a farm with a UF or RO system will be treated as producer milk at the pool plant at which the milk is physically received or, if the retentate is shipped to a nonpool plant, as producer milk diverted to a nonpool plant. In either case, the milk or milk components will be priced at the pool plant or nonpool plant where the milk is physically received.

To be considered a farm and a producer, as opposed to a plant and a handler, an RO or UF unit must be under the same ownership as the farm on which it is located and only milk from that farm or other farms under the same ownership may be processed through the unit. The producer operating the unit shall be responsible for providing records of the daily weights of the milk going through the unit. Also, the producer must provide samples for each load of milk going through the unit and must furnish the receiving plant with a manifest on each load of retentate showing the scale weight along with samples of the retentate. Finally, the producer operating the RO or UF unit must maintain records of all transactions which must be available to the Market Administrator upon request. If the producer does not meet these recordkeeping and reporting requirements, the unit will be considered to be a plant.

RO and UF retentate will be considered to be producer milk at the plant which receives it. The pounds of

RO and UF retentate received will be priced according to the skim-equivalent pounds of such milk. The skim-equivalent pounds for RO retentate will be determined by dividing the solids-not-fat pounds in the retentate by the average producer solids-not-fat in the skim portion of the producer milk used in the product. The butterfat pounds would then be added to this number to arrive at the product skim-equivalent pounds.

In computing the fluid equivalent of UF retentate, the fluid equivalent factor should be computed by dividing the true protein test in the skim milk portion of the retentate by the true protein test in the skim milk portion of the producer milk used in the product. Adding the butterfat pounds to this computation will yield the product equivalent pounds.

In addition to having UF and RO equipment, some farms today may have a separator to separate skim milk from cream before they leave the farm. Rules must also be established for this type of operation.

Skim milk and cream going through a farm separator also should be treated as producer milk if received at a pool plant or diverted to a nonpool plant. The producer will be required to obtain scale weights and tests on each load of skim and cream shipped along with samples of each. The same ownership, recordkeeping, sampling and reporting requirements that apply to RO and UF units will also be applicable.

In formulating a policy for the treatment of RO and UF retentate, it is important to recognize that the milk produced on a farm with RO or UF equipment is fully available to meet the needs of the fluid market, either before or after passing through such units. Therefore, there should be no question concerning the propriety of pooling this milk along with other producers' milk.

At this writing, the Food and Drug Administration (FDA) has not yet decided whether UF retentate can be reconstituted and sold as fluid milk. However, FDA has approved the use of UF retentate in certain cheese products on a trial basis. Therefore, before receiving UF retentate for use in any product, handlers should be certain that such use has been approved by the FDA.

Distributing Plant

A *distributing plant* is defined as a plant that is approved by a duly constituted regulatory agency to handle Grade A milk and at which fluid milk products are processed or packaged and from which there is route disposition. The time and location of route disposition are included in the

distributing plant definition in some current orders. However, whether route disposition occurred during the month or, within the marketing area, are more appropriately determined to be pooling issues. Therefore, they are discussed and included in each consolidated order's pool plant definition.

Supply Plant

A *supply plant* is a regular or reserve supplier of bulk milk for the fluid market that seasonally contributes to coordinating the supply of milk with the demand for milk in a market. As defined in this decision, a supply plant is a plant other than a distributing plant that is approved by a duly constituted regulatory agency to handle Grade A milk and at which fluid milk products are received or from which fluid milk products are transferred or diverted.

Pool Plant

The *pool plant* definition of each proposed consolidated order provides standards to distinguish between those plants engaged in serving the fluid needs of the marketing area and those plants that do not. Pool plants serve the market to a degree that warrants their producers sharing in the added value that derives from the classified pricing of milk. While the pool plant definition in every consolidated order provides for a set of common principles, the definition is specific and unique to each consolidated order.

Each type of pool plant can be generically described to share certain common characteristics. However, to the extent that marketing conditions and other related factors vary across the country, the proposed consolidated orders need differing terms of applicability and performance standards in order to determine the regulatory status of a plant.

All *pool distributing plants* in the consolidated orders will base pool plant status on two performance measures: (1) the proportion of its route disposition to bulk receipts, and (2) the proportion of route disposition in the marketing area. If a pool distributing plant operates in more than one market, the plant's primary association with a marketing area generally will be determined on the basis of where the majority of fluid sales occur. In the event that a plant is not primarily associated with any marketing area, it will be regulated in the marketing area in which it is located provided the plant meets the order's pooling standards. If it is not located within any marketing area, it will be regulated wherever it has the most route disposition.

Performance standards for *pool supply plants* are designed to attract an adequate supply of milk to meet the demands for fluid milk in a market. Historically, a pool supply plant did not include any portion of a plant that was not approved for handling Grade A milk and that was physically separated from a portion of the plant that had approval. Currently, inspection agencies most commonly render only one type of approval for an operation, but provision is made to designate a physically separated portion of the plant as a "nonpool plant."

Types of Pool Plants and Pool Qualifications Pool Distributing Plant

Many orders presently refer to Grade A milk in defining a pool distributing plant. However, a distributing plant, by definition, can only handle Grade A milk, so this qualification is redundant and has been removed from the structure of the pool plant section. Also, as proposed here, the proportion of route disposition to receipts is derived from a divisor of receipts of bulk fluid milk products as opposed to receipts of total fluid milk products.

The recommended ratio of route disposition to total receipts of bulk fluid milk products for *pool distributing plant* qualification will vary among orders, but for most orders it will be at least 25 percent. This is the lowest ratio currently used among all orders, and will prevent depooling of plants that presently enjoy pool plant status. To the extent this percentage is found to be too low for certain milk "deficit" regions, higher percentages are provided in those proposed consolidated orders.

Performance standards are also needed to establish a minimum threshold of market participation, as measured by route dispositions in a marketing area, which when met or surpassed, cause a distributing plant to be fully regulated in that market. Currently, the proportion of route disposition in the marketing area is expressed in some orders as a percentage of total route disposition and in other orders as a percentage of total receipts of fluid milk products. A percentage of total route disposition is recommended for the consolidated orders.

Some current orders require a daily average minimum of route disposition in the marketing area. This standard has been removed because it is covered under the exempt distributing plant definition described below. The recommended ratio of 15-25 percent of a plant's route disposition in the marketing area provides a reasonable measure of a distributing plant's

association with a marketing area, while, at the same time, precluding a change in the regulatory status of plants that are currently partially regulated or regulated by a state regulatory program.

To facilitate proper administration and accounting, all orders currently provide that packaged fluid milk products transferred from one handler to another be treated as interhandler transfers, with each transaction properly identified and specifically reported to affected market administrators. This should continue in the consolidated orders. However, for the single purpose of qualifying a plant as a pool distributing plant, a subsection in each consolidated order is included to address the transfer of packaged fluid milk products to a distributing plant. Packaged fluid milk products that are transferred to a distributing plant shall be considered as route disposition from the transferring plant rather than the receiving plant. In addition to transfers that occur for sales in the marketing area, this subsection is also meant to address the concern of properly pooling a plant with sales outside of the marketing area that are made through another plant. This is necessary to preclude a plant from becoming partially regulated if the plant shipped significant quantities of packaged fluid milk products to another distributing plant.

Pool Supply Plant

Currently, pool supply plants are generally defined by their association with a marketing area and their ability to move milk to pool distributing plants that service the marketing area. Pool supply plants should continue to be defined in this way. However, the pool supply plant definition does not lend itself to uniform application in all consolidated orders. Therefore, pool supply plant performance standards should be established according to regional needs. The specific standards adopted in each order are described in the pool plant section of each new order. For orders outside the southeastern United States, provisions are provided for two types of supply plants: a *pool supply plant* and *pool reserve supply plant*. Pool reserve supply plants are generally defined as plants located within the marketing area that are involved primarily in manufacturing nonfluid milk products. They nevertheless serve to balance the market by providing a ready supply of fluid milk when needed and a manufacturing alternative when milk for fluid uses is not needed. By contrast, pool supply plants are generally defined as plants involved predominately in the

assembly of raw milk supplies at the farm and shipment of these supplies to distributing plants. There are proposed marketing areas where just a pool supply plant provision would be adequate, without the additional distinction of a pool reserve supply plant. For those marketing areas where it is preferable to distinguish between plants located in and out of the marketing area, different performance requirements are recommended to fit the needs of the consolidated order.

Pool Reserve Supply Plant

A pool reserve supply plant is defined as a plant capable of handling the reserve milk required for a marketing area that also stands ready to make milk available to meet the fluid needs of the market. Such a plant must be approved to handle Grade A milk, and must be located in the marketing area. In addition, the plant must provide milk in fluid use to pool distributing plants certain month of the year when milk production declines. Finally, a *reserve supply plant* must apply for, and receive, formal acknowledgment of pool status by the market administrator. Because deliveries of a pool reserve supply plant to a distributing plant will specify seasonal performance standards, they cannot be uniform across all orders. Therefore, each proposed consolidated order having a pool reserve supply plant definition will differ with respect to the level and timing of performance required.

In qualifying a supply plant's milk receipts for pooling, several current orders allow direct milk shipment from farms to distributing plants, while other current orders require all of the milk, or at least some of it, to be transferred through a plant. Transferring deliveries through a plant may often be uneconomical and inefficient when compared to the direct delivery of milk from farms. Therefore, for most of the consolidated orders, both supply plants and reserve supply plants are allowed the flexibility to meet delivery requirements by direct deliveries from farms to distributing plants if the supply plant operator deems that to be the most efficient means of moving milk.

A number of orders currently provide for special pool status for supply plants located in the marketing area but such status is generally limited to cooperatives. Several of the orders which have this provision will retain it under the consolidated orders. In other orders, however, especially those with many manufacturing plants operated by proprietary handlers, ownership distinction as a condition for pool reserve supply plant status has been

removed. This should promote increased handler equity in the ability for plants to compete for milk supplies and for producers associated with such plants to have their milk priced and pooled under the order. Additionally, there are manufacturing plants located in some marketing areas that are currently designated as pool plants. This provision will ensure the retention of pool status of such plants.

Location in the marketing area should also be a requirement for pool reserve supply plant status. This is recommended because it will preclude the pooling of a plant that is outside the marketing area and not in a position to economically supply the market with supplemental milk or to efficiently handle its reserve supplies. In addition, it will preclude the pooling of milk on a market when such milk has no real association with the market at all and only serves to lower a market's Class I utilization, thereby making it more difficult to attract milk needed for fluid use. When a distributing plant needs more milk, a reserve supply plant located in the marketing area can most rapidly and economically route milk directly to where it is needed.

For those orders providing for reserve supply plants, pool plant status will be conveyed by the market administrator after notification is filed in writing by the plant operator. The notification should be filed no later than June 15 of each year. Pool status would begin on July 1 of the same year and continue for the remainder of the year unless: (1) the plant operator later requests nonpool plant status; (2) the plant subsequently fails to meet the specified performance standards, or; (3) the plant qualifies as a pool plant under another Federal order. If a plant operator requests nonpool status for any month, such nonpool status should remain in effect until the following June, when the cycle of notification for pool reserve supply plant status begins anew. Notification to the market administrator serves to demonstrate a commitment to the market and to act as a deterrent to temporary changes in pooling status to the detriment of the market.

Pooling Options

Unit pooling. Unit pooling allows two or more plants located in the marketing area and operated by the same handler to qualify for pool status as a *unit* by meeting the total and in-area route disposition standard as if they were a single pool distributing plant. To qualify as a *unit*, at least one of the plants in the *unit*—i.e., the primary plant—must qualify as a pool distributing plant on its own standing and the other plants in

the unit must process only Class I or Class II milk products.

Unit pooling serves to accommodate and provide a flexible regulatory approach in addressing the specialization of plant operations. It also minimizes unintended regulatory effects that may cause the uneconomical and inefficient movement of milk for the sole purpose of retaining pool status. However, some conditions need to be satisfied for unit pooling. The "other" plant(s) of the pool unit—i.e., the plants that would not qualify for pool status as a single plant—must be located in an equivalent or a lower price zone than the primary pool distributing plant. This condition is required to assure that the transportation of milk for Class II uses will not be subsidized through the marketwide pool and to assure pricing equity to all handlers processing Class II products that do not use unit pooling. Unit pooling arrangements status must be requested in writing and approved by the market administrator for its proper implementation and administration.

System pooling. As previously discussed, supply plants and reserve supply plants provide a benefit to the market because they are required to meet certain performance standards in supplying the needs of the fluid market. They also serve to balance the market. Because handlers often operate more than one supply plant within the market, they should be afforded flexibility in meeting the performance standards for pooling. *System pooling* can provide this flexibility. A system of plants can be established if the plants meet applicable performance standards in the same manner as any single plant. A system may consist of two or more supply plants, or two or more reserve supply plants, operated by the same handler or by one or more cooperative associations.

System pooling should be declared by a handler in writing to the market administrator so that pooling of the system can be properly administered. If a handler causes one of the plants to become ineligible for system pooling, that plant will not be part of the system for the duration of the calendar year. Likewise, plants, except for the proposed Upper Midwest consolidated marketing area, cannot be added to the system after the written request for system pooling is acknowledged by the market administrator.

Adjustment of Pooling Standards

The consolidated orders should provide the market administrator with authority to adjust various pooling standards, including pool plant shipping standards in most consolidated

orders. Such a provision would replace the "call" provision that is now included in some orders. This change allows all market administrators to adjust the shipping standards for pool supply and pool reserve supply plants if they find that such revision is necessary to encourage needed shipments or to prevent uneconomic shipments of milk. For most consolidated orders, it is also recommended that the market administrator be authorized to adjust the total and in-area route disposition requirements for pool distributing plants. This flexibility could be particularly beneficial during a plant breakdown, a labor strike, the sudden loss or change in accounts, or some other conditions that would otherwise result in regulatory instability or market disruption.

A finding by the market administrator that adjustments are warranted would follow an investigation conducted on the market administrator's own initiative or at the request of interested parties. This provision allows the market administrator to respond promptly to changes in local marketing conditions. Granting the authority for the market administrator to make needed adjustments in the manner specified currently exists in some Federal orders and has proven to be responsive, efficient, effective, and commensurate with the authorities already delegated by the Secretary to the market administrator.

Nonpool Plant

A definition is provided in all orders describing plants which receive, process or package milk, but which do not satisfy the standards for being a pool plant. While providing for such a definition may appear redundant, this provision is useful to more clearly define the extent of regulation applicable to plants. *Nonpool plants* should include a plant that is fully regulated under another Federal order, a producer-handler plant, a partially regulated distributing plant, an unregulated supply plant and an exempt plant. The definitions for these nonpool plants are not materially different than those provided in the current orders with the possible exception of an "exempt plant."

A number of Federal orders exempt from regulation small distributing plants which, because of their size, do not significantly impact competitive relationships among handlers in the market. The level of route disposition required before an exempt plant becomes regulated varies in the current orders. As recommended, any plant

with route disposition during the month of 150,000 pounds or less would be exempt in the consolidated orders. This limit reflects the maximum amount of fluid milk products allowed by an exempt plant in any current Federal milk order and ensures plants that are currently exempt from regulation will remain so.

Many current Federal orders also provide regulatory exemption for a plant operated by a state or Federal governmental agency. For example, some states have dairy farm and plant operations that provide milk for their prison populations. As recommended, regulatory exemption would be continued under the consolidated orders unless pool plant status is desired. Additionally, regulatory exemption is intended to include colleges, universities and charitable institutions because these institutions generally handle fluid milk products internally and have no impact in the mainstream commercial market. However, in the event that these entities do distribute fluid milk through commercial channels, route sales by such entities, including government agencies, will be monitored for determining if Federal regulation should apply.

The determination and verification of exempt plant status will, from time to time, necessitate the need for the market administrator to require reports and information deemed appropriate for the sole purpose of making this determination. Such authority is currently provided in orders and should continue.

Handler

Federal milk orders regulate those persons who buy milk from dairy farmers. Such persons are called *handlers* under the order. These persons have a financial responsibility for payments to dairy farmers for milk in accordance with its classified use. They must file reports with the market administrator detailing their receipts and utilization of milk. As recommended, the handler definition includes the operator of a pool plant, a cooperative association that diverts milk to nonpool plants or delivers milk to pool plants for its account, and the operator of a "nonpool plant," which would encompass a producer-handler, a partially regulated distributing plant, a plant fully regulated under another Federal order, an unregulated supply plant, and an exempt plant.

In addition, "third party" organizations that are not otherwise regulated under provisions of an order are included in the handler definition.

This category includes any person who engages in the business of receiving milk from any plant for resale and distribution to wholesale and retail outlets, brokers or others who negotiate the purchase or sale of fluid milk products or fluid cream products from or to any plant, and persons who, by purchase or direction, cause the milk of producers to be picked up at the farm and/or moved to a plant. Such intermediaries provide a service to the dairy industry. These persons are not, however, recognized or regulated as entities required to make minimum payments to producers. The expanded marketing chain brought about by such intermediaries has made it increasingly difficult for the market administrator to track the movement of milk from farms to consumers. The recommended handler definition enables the market administrator to more readily identify those entities for the information needed to properly administer an order.

Producer-Handler

It has been a long-standing policy to exempt from full regulation many of those entities that operate as both a producer and a handler. Generally, a *producer-handler* is any person who provides satisfactory proof to the market administrator that the care and management of the dairy farm and other resources necessary for own-farm production and the management and operation of the processing plant are the personal enterprise and risk of such person. A primary basis for exempting producer-handlers from the pricing and pooling provisions of a milk order is that these entities are customarily small businesses that operate essentially in a self-sufficient manner. Also, during the history of producer-handler exemption from full regulation there has been no demonstration that such entities have an advantage as either producers or handlers so long as they are responsible for balancing their fluid milk needs and cannot transfer balancing costs, including the cost of disposing of reserve milk supplies, to other market participants.

The current orders have varying producer-handler definitions that address specific marketing conditions and circumstances. For example, they specify different limits on the amount of milk that producer-handlers may purchase and retain their exempt status. Some modifications are being made to the producer-handler provisions in the consolidated orders for standardization. However, these changes are not intended to fully regulate any producer-handler that is currently exempt from regulation.

As proposed, any handler, including a producer-handler, is exempt from the pooling and pricing provisions of an order during any month in which route disposition is less than 150,000 pounds. Thus, the producer-handler exemption only applies to producer-handlers with route disposition of 150,000 pounds or more. Since such producer-handlers are not subject to the pricing and pooling provisions of an order as are fully regulated handlers, it is appropriate to continue to require producer-handlers to rely on their own-farm production in meeting their fluid sales and to independently market their surplus milk production without participation in the marketwide pool. However, a producer-handler should be allowed some marginal flexibility on supplemental milk purchases provided they are from regulated sources. Relatively small supplemental purchases do not undermine the concepts of classified pricing and marketwide pooling. As proposed, producer-handlers are allowed to purchase some specified amount of supplemental fluid milk products each month from pool sources. As is currently the case, any supplemental requirements of fluid milk products by a producer-handler will continue to be limited to receipts from regulated sources, thus insuring that producers associated with the marketwide pool share in the economic benefit of all Class I sales over and above what a producer-handler's own production may not have satisfied.

It is appropriate to continue requiring producer-handlers to rely primarily on their own-farm production to balance their fluid sales and to find outlets for their surplus production. Producer-handlers must also rely upon their own distribution system to find outlets for their milk. A producer-handler will be allowed to distribute milk to the plant of a fully regulated handler. However, disposal of surplus milk production by a producer-handler to the plant of a fully regulated handler, whether in bulk or packaged form, will be allocated at the pool plant to the lowest class-use of the receiving plant, thereby preserving the Class I share of the market for producers who bear the burden of balancing a market's surplus disposal. Disposal of packaged fluid milk products by a producer-handler to a distribution facility operated by a fully regulated handler should not be permitted. It would allow a producer-handler to dispose of its surplus production by capturing a greater share of the Class I market thereby receiving an unearned economic benefit not

accorded to producers pooled on the market. This restriction also prevents a fully regulated handler from purchasing Class I milk at less than the minimum order price that other fully regulated handlers must pay. Accordingly, a producer-handler will not be allowed to dispose of fluid milk products using the distribution system of another handler, nor through any other channel, division, or department of a pool handler and retain exemption from full regulation under an order. Since a producer-handler must control its own distribution, it will not be allowed to have disposed of milk to any independent distributor. Route disposition to retail stores (owned by any entity and not located in a regulated plant) or to a distribution facility owned by retail stores (and not by a regulated plant or independent entity) would be allowed.

Notwithstanding the exemption of producer-handlers from regulation, there may be instances where it is to the advantage of the person who is both a producer and a handler to operate such businesses as two distinct entities. The proposed new orders provide the producer-handler with the flexibility to realize this advantage. Upon request by a producer-handler to the market administrator, the plant portion of the operation would be a fully regulated distributing plant while the farm portion of the operation would be accorded producer status.

Public comments were received regarding the extent of regulation that should apply to producer-handlers. The majority of public comments supported the status-quo regarding the regulatory treatment of producer handlers, emphasizing that they should remain exempt from regulation in accordance with current order provisions and that the provisions should be regional in nature so as not to affect or change the current regulatory status of producer-handlers. One of the public comments received proposed that the exemption of producer-handlers from the regulatory plan of milk orders be eliminated. This proposal is denied. In the legislative actions taken by the Congress to amend the AMAA since 1965, the legislation has consistently and specifically exempted producer-handlers from regulation. The 1996 Farm Bill, unlike previous legislation, did not amend the AMAA and was silent on continuing to preserve the exemption of producer-handlers from regulation. However, past legislative history is replete with the specific intent of Congress to exempt producer-handlers from regulation. If it had been the intent of Congress to remove the exemption, Congress would

likely have spoken directly to the issue rather than through omission of language that had, for over 30 years, specifically addressed the regulatory treatment of producer-handlers.

Since producer-handlers are intended to be exempt from most regulation, some means must be provided to determine and to verify producer-handler status. Accordingly, the market administrator is provided with the authority to require reports and other information deemed appropriate to determine that an entity satisfies the requirements of producer-handler status. Such authority is currently provided in the orders and should continue.

Producer

Under all orders, *producers* are dairy farmers that supply the market with milk for fluid use or who are at least capable of doing so if necessary. Producers are eligible to share in the revenue that accrues from marketwide pooling of milk. The producer definitions of the individual orders are described under the regional discussions later in this document. Responding to regional needs, producer definitions will differ by order with respect to the degree of association that a dairy farmer must demonstrate with a market.

A dairy farmer may not be considered a producer under two Federal milk orders with respect to the same milk. If a dairy farmer's milk is diverted by a handler regulated under one Federal order to a plant regulated under another Federal order, and the milk is allocated at the receiving plant (by request of the diverting handler) to Class II, III or IV, the dairy farmer will maintain producer status in the original order from which milk was diverted.

Since producer-handlers and exempt plants are specifically exempt from Federal order pricing provisions, the term producer should not include a producer-handler as defined in any Federal order. Likewise, the term producer should not apply to any person whose milk is delivered to an exempt plant, excluding producer milk diverted to such exempt plant.

It would not be appropriate to share the economic benefits that arise from classified pricing through marketwide pooling with dairy farmers whose milk is not regularly associated with the market. For example, a dairy farmer may decide to deliver milk to a market's pool plants only when a more favorable unregulated market is not available, or an unregulated plant may attempt to move its surplus milk to a market's pool

plant only to derive an economic benefit from the marketwide pool.

An unregulated plant operator, often a cooperative association, may receive all of a dairy farmer's milk at its plant when milk supplies are tight and, during such times, not share the higher-use value of such milk with other dairy farmers through the marketwide pool. On the other hand, during a period of flush production, the same plant may seek to dispose of surplus milk through a market's pool plants to pass the cost of balancing milk supplies to dairy farmers that regularly supply the fluid market through the mechanism of the marketwide pool. Under such circumstances, producer status should not be accorded to those dairy farmers under an order. Doing so would place producers who regularly fulfill a market's fluid milk needs with the burden of carrying the surplus costs of balancing unregulated fluid markets without the benefit of sharing in the additional revenue that is derived from those markets when circumstances are more favorable.

Another circumstance can also arise when it may be advantageous not to pool milk, a practice commonly referred to as "depooling." When manufacturing class prices for a month are higher than an order's uniform, or blend price, milk at manufacturing plants is often depooled because the operators of such plants otherwise would be required to pay into the marketwide producer-settlement fund. Such payments would benefit the marketwide pool but would be disadvantageous to those having to make them. This practice is generally disruptive to the marketwide pool and is not conducive to maintaining orderly market conditions. In instances involving depooled milk, it is a handler's decision in moving milk that impacts producers and pool milk value. It is also a handler's action that determines whether a farmer retains producer status or becomes associated with another marketing area.

The proposed orders that are vulnerable to this type of abuse contain a provision to deter handlers from moving milk in a manner that is disadvantageous to the market's regular producers. Handlers who choose to regularly supply nonpool plants as their primary market, and handlers who move milk in and out of the regulated market, should not consistently enjoy the benefits of equalization payments from the marketwide pool. However, this should not apply in the event that a handler moves milk supplied by a producer under one Federal order to another Federal order, nor are these provisions intended to overlap with

order provisions for the diversion of milk. Should a handler exceed specified diversion limits, only the over-diverted milk is removed from the pool; the producer should maintain "producer" status for other milk delivered that month.

The recommended method for determining when a dairy farmer is not properly associated with a market is commonly referred to as a "dairy farmer for other markets" provision, which is a component of the producer definition in some of the consolidated orders. Under this type of provision, milk deliveries to nonpool plants that are not reported by handlers as diversions from pool plants would result in the loss of producer status for a dairy farmer's milk for some fixed time period. While the receipt of, or diversion by, a pool handler of other milk from the same producer during that fixed time period is not restricted, the minimum payment obligation of the handler for that milk would not be regulated under the Federal milk marketing orders. Such milk would be treated as "other source milk," and the dairy farmer's milk would not be included in the pool.

Where this provision is provided, the loss of producer status would remain in effect for the current month and for the following two months. Exception is made to accommodate the market demands for milk during the "short" season. If milk is depooled during the "short" season, the loss of producer status should remain in effect for the current month only; otherwise, it would discourage the pooling of milk during the remainder of the "short" season. Once the short season ends, however, the dairy farmer should not be eligible for producer status during the subsequent flush production season. Producer status will be lost until the beginning of the following "short" season. The relevant time periods that describe which months are applicable in defining the "short" season are described in each of the consolidated orders.

Producer Milk

All orders currently provide for defining and identifying the milk of producers which is eligible for inclusion in a particular marketwide pool and should continue to do so. However, this definition is specific to each consolidated order and is therefore not uniform across all orders.

In general, the definition of *producer milk* for all consolidated orders continues to include the milk of a producer which is received at a pool plant or which is received by a cooperative association in its capacity as

a handler. Most current orders consider milk to be "received" when it is physically unloaded at the plant and the proposed orders would continue that treatment. However, to ensure that producers are promptly paid for their milk, milk picked up from the producer's farm, but not received at a plant until the following month, will be considered as having been received by the handler during the month in which it is picked up at the producer's farm. In this situation, milk will be priced under an order at the location of the plant where it is physically received in the following month.

In order to promote the efficient movement of milk, all orders currently allow a handler to move producer milk, within certain specified limits, from a producer's farm to a plant other than the handler's own plant. This is referred to as a "diversion" of milk. As proposed for the consolidated orders, the definition of producer milk allows unlimited diversions to other pool plants, thereby providing maximum flexibility in efficiently supplying the fluid market.

Under some orders, unlimited diversions to nonpool plants would also be allowed once a dairy farmer has become associated with a particular order. Under other orders, however, a producer would be required to "touch base" at a pool plant one or more times each month and, in addition, aggregate diversion limits may be applied to a handlers' total diversions.

For pool distributing plants, route disposition as a percent of total receipts of bulk milk automatically limits diversions by those plants. With respect to pool supply plants and pool reserve supply plants, the specific shipping standards will ensure that a sufficient quantity of milk is available for the fluid market. Since some orders may allow for unlimited diversions, the maximum quantity of milk that a pool plant would be able to divert and still maintain its pool plant status would be 100% less the pool plant shipping standards for the month. This will mitigate the need for suspending order diversion limitations, an action that is quite common in some of the current orders. Unlimited diversions would also allow for maximum efficiency in balancing the market's milk supply. The market administrator's ability to adjust shipping percentages for pool supply plants and pool reserve supply plants will further ensure that an adequate supply of milk is available for the fluid market without the imposition of diversion limits.

While it is expected that a one time producer "touch base" standard and

virtually unlimited diversions would be appropriate for most of the consolidated Federal orders, it is recognized that it may not be appropriate for certain "deficit" markets. In these cases, the order may provide for diversion limits to ensure an adequate supply of fluid milk for that particular market. In these cases, the alternate standards for diversion privileges specify the minimum number of days that milk of a producer must be physically received at a pool plant and the percent of total producer receipts that may be diverted by the handler. The months during which such minimums must be met are also identified in both cases.

In order to provide regulatory flexibility and marketing efficiencies, all of the proposed orders having diversion limits allow the market administrator to increase or decrease the delivery requirements for producers and the aggregate diversion limits applicable to handlers. Granting the authority for the market administrator to make needed adjustments in the manner specified currently exists in some Federal orders and has proven to be a responsive, efficient, and effective way to deal with rapidly changing marketing conditions.

Cooperative Association

All current orders provide a definition for dairy farmer cooperative associations that market milk on behalf of their dairy farmer members and should continue to do so in the consolidated orders. Providing for a uniform definition of a cooperative association facilitates the administration of the various order provisions as they apply to such producer organizations and recognizes the unique standing granted to dairy farmer cooperatives under the Capper-Volstead Act. Moreover, dairy farmer cooperatives are responsible for marketing the majority of the milk supplied to regulated handlers under the Federal order system.

As provided herein, a cooperative association means any cooperative marketing association of producers which the Secretary determines, after application for such recognition by the cooperative, is qualified as such under the provisions of the Act of Congress of February 18, 1922, as amended, known as the "Capper-Volstead Act". Additionally, most orders currently require that a cooperative association have full authority in the sale of the milk of its members and that it be engaged in making collective sales or marketings of milk or milk products for its dairy farmer members. This should continue. The cooperative association definition provides for universal applicability in all consolidated orders.

Several current orders also provide a definition for a federation of two or more cooperative associations. As recommended herein, all consolidated orders would recognize a federation of cooperatives as satisfying the cooperative definition for the purposes of determining milk payments and pooling. Individual cooperatives of a federation of cooperatives must also meet the criteria as set forth for individual cooperative associations and their federations as incorporated under state laws.

Handler Reports

Reports of receipts and utilization, payroll and other reports. All current orders require handlers to submit monthly reports detailing the sources and uses of milk and milk products so that market average use values, or blend prices, can be determined and administered. Payroll reports and other reports required by the market administrator are also provided for in the orders. The proposed language for the consolidated orders for handler reports is similar to that contained in current orders. The dates when reports are due in the market administrator's office differ slightly by order according to custom and industry practice.

Announcements by the Market Administrator

Public announcements by market administrators. Four sections of each consolidated order provide for requiring the market administrator to make certain announcements in the course of order administration. These include: § 100_.45, Market administrator's reports and announcements concerning classification; § 100_.53, Announcement of class prices and component prices; § 100_.54, Equivalent price; and § 100_.62, Announcement of producer prices, or in orders without component pricing, Announcement of uniform price, uniform butterfat price, and uniform skim milk price. These announcements are currently required by market administrators in all orders and should continue. As proposed, these provisions are uniform to all consolidated orders and are nearly identical to current order provisions. However, § 100_.62, is unique to each order and is described in each of the consolidated orders.

Payments for Milk

Producer-settlement fund. All of the current orders provide for minimum payment terms and obligations by regulated handlers and such provisions should continue to be part of the consolidated orders. Handlers are

charged with minimum class prices. However, producers are returned a uniform, or blend, price through the marketwide pooling of milk. The mechanism for the equalization of a handler's use value of milk is the producer-settlement fund. It is established and administered by the market administrator for each order.

The producer-settlement fund ensures that all handlers are able to return the market blend price to producers whose milk was pooled under the order. Payments into the producer-settlement fund are made each month by handlers whose total classified use-value of milk exceeds the value of such milk calculated at the uniform price or at component prices for those orders with component pricing. Similarly, payments out of the producer-settlement fund are made each month to any handler whose use-value is below the value of milk at the uniform price or component prices, as the case may be. The transfer of funds enables handlers with a use-value below the average for the market to pay their producers the same uniform price as handlers whose Class I utilization exceeds the market average. This provision is uniform for all consolidated orders.

Payments to and from the producer-settlement fund. The current orders vary with respect to dates for payments to the producer-settlement fund, due largely to industry practices and how certain orders evolved over time to reflect those practices. Each consolidated order provides for payment dates, and they are specific for each consolidated order. Also, as proposed, payment to the producer-settlement fund would be considered made upon receipt by the market administrator. In view of the need to make timely payment to handlers from the producer-settlement fund, it is essential that money due the fund be received by the due date. Additionally, payment cannot be received on a nonbusiness day. Therefore, if the due date is a Saturday, Sunday, or national holiday, payment would not be due until the next business day. This is specified in § 1000.90 of the General Provisions.

Payments from the producer-settlement fund provide for payments to those handlers whose milk use-value is below the value of milk at the uniform price. As proposed, this section is similar to those contained in current orders. As with payments to the producer-settlement fund, the payments from the fund are specific to each consolidated order. Generally, payments from the producer-settlement fund would be required one day after the required date for payments into the

fund. This goal is consistent with the average time lapse between payment into the producer-settlement fund and payments from the fund in existing orders. As in the prior section, payments would be made on the next business day when the required payment date falls on a Saturday, Sunday, or national holiday.

Payments to producers and to cooperative associations. The AMAA provides that handlers must pay to all producers and producer associations the uniform price. The existing orders generally allow proper deductions authorized by the producer in writing. Proper deductions are those that are unrelated to the minimum value of milk in the transaction between the producer and handler. Producer associations are allowed by the statute to "reblend" their payments to their producer members. The Capper Volstead Act and the AMAA make it clear that cooperative associations have a unique role in this regard.

The payment provisions to producers and cooperatives vary greatly among the current Federal orders, particularly in regard to partial payment frequency, timing, and amount. The proposed provisions are consistent with the needs of the consolidated orders. Each order currently requires handlers to make at least one partial payment to producers in advance of the announcement of the applicable uniform prices. The partial payment varies across orders by the required payment date, rate of payment, and volume of milk for which payment is made. This provision continues to require partial payments, although they will vary by consolidated order. Full payment is required to be made so that it is received by producers no later than two days after the required pay-out date of monies from the producer-settlement fund.

Cooperatives will be paid by handlers for bulk milk and skim milk on the terms described for individual producers except that required receipt of payment will be one day earlier. Providing for an earlier payment date for cooperative associations is warranted because it will permit the cooperative association the time needed to distribute payments to individual producer-members. The cooperative payment language in each of the consolidated orders has been expanded to include bulk milk and skim sold by cooperative pool plants as well as by cooperatives acting as a handler.

All of the payment dates are receipt dates. Since payment cannot be received on a non-business day, payment dates that fall on a Saturday, Sunday, or national holiday will be delayed until

the next business day. While this has the effect of delaying payment to cooperatives and producers, the delay is offset by the shift from "date of payment" to "date of payment receipt."

Minimum payments to producers. In a proceeding involving the current Carolina, Southeast, Louisville-Lexington-Evansville, and the former Tennessee Valley Federal milk orders (Orders 5, 7, 46, and 11), a proposal was made to clarify what constitutes a minimum payment to producers. The proposal was recommended by Hunter Farms (Hunter) and Milkco Inc. (Milkco), two handlers regulated under the current Carolina order. Under the proposal, a handler (except a cooperative acting in its capacity as a handler pursuant to paragraph 9(b) or 9(c)) may not reduce its obligations to producers or cooperatives by permitting producers or cooperatives to provide services which are the responsibility of the handler. According to the Hunter/Milkco proposal, such services include: (1) Preparation of producer payroll; (2) conduct of screening tests of tanker loads of milk; and (3) any services for processing or marketing of raw milk or marketing of packaged milk by the handler.

At the May 1996 hearing, representatives of Hunter and Milkco testified that both handlers receive milk from cooperative associations and Piedmont Milk Sales, a marketing agent handling the milk of non-member producers. The Hunter representative explained, due to competitive marketing conditions in the Southeast in late 1994 and early 1995, handlers were able to purchase milk supplies at Federal order minimum prices without any over-order premiums being charged. As a result of the absence of over-order premiums, the representative stated, Hunter received underpayment notices from the market administrator on milk that it had received from Piedmont Milk Sales.

Hunter contends the problem of what constitutes a minimum payment to producers should be clarified in the event that premiums again disappear in the future. If this issue is not resolved, according to Hunter, it will suffer a loss of milk sales and its producers will receive lower prices. Hunter argues that the current policy is discriminatory and unfair and that everyone would benefit from a clarification of the rules defining Federal order minimum prices.

Milkco supported Hunter's position and stated that it also received underpayment notices from the market administrator for the December 1994 through October 1995 period on milk received from independent dairy farmers, but did not receive

underpayment notices on milk received under the same or similar conditions from cooperative associations.

Carolina-Virginia Milk Producers Association offered qualified support for the Hunter/Milkco proposal. The cooperative suggested expanding handlers' responsibilities to cover tanker washing and tagging, supplying milk to handlers on an irregular delivery schedule, field work, disposing of surplus milk during months when the supply is above local needs, and importing supplemental milk for Class I use during periods of short production.

Mid-America Dairymen, Inc. (Mid-Am) testified and filed a post-hearing brief strongly objecting to the Hunter/Milkco proposal. Mid-Am argued that the issue of minimum payments to producers is national in scope and suggested that the issue be addressed on a national basis within the context of the Federal order reform as required by the 1996 Farm Bill. Furthermore, Mid-Am stated that clearly the costs for butterfat testing are borne by all producers, and the costs of testing milk in tankers for antibiotics are borne by all handlers, regardless of their source of supply. According to Mid-Am, no confusion exists as to who is responsible for these tests and, therefore, they should not be included in the proposed amendments.

Several handlers either supported the Milkco/Hunter proposal or stated the proposal should be considered by the Secretary for all Federal milk marketing orders within the context of Federal milk order reform.

Based on the testimony presented at the public hearing and comments received, the Department's recommendation issued on July 17, 1997 (62 FR 39470), was to consider this issue as part of Federal order reform. The decision stated that no changes were being recommended for the 4 southeastern orders involved in the proceeding because this issue is central to all Federal milk orders and should not be interpreted differently from one order to another. The decision also noted the conceptual differences among market participants concerning what constitutes minimum prices to producers. The record was not extensive in detailing the particular services to be assigned to each party, nor in providing guidance concerning the cost of these services which appeared to vary considerably from organization to organization.

Hunter and Milkco, Inc., filed an exception to the Department's partial recommended decision and urged adoption of their proposal. These handlers stated that their proposal

would specify the responsibility of all handlers with respect to producer milk and thereby rectify any inconsistency that may currently exist in order language concerning this issue.

Hunter and Milkco also stated that any disagreement within the industry concerning which services are the responsibility of the handler is secondary to the issue under review and does not warrant the denial of their proposal. The commenters contend that the central principle surrounding this issue is uniformity in the treatment of handlers purchasing milk supplies from cooperatives or independent producers. The precise list of services is of secondary importance, they state, and industry disagreement concerning these services should not prevent the Department from embracing the central thrust of their proposal.

Regardless of the short-term outcome in the pending rulemaking, there is a long-term issue that transcends individual orders and should be uniformly applied in the interpretation and administration of all Federal milk orders if possible. Accordingly, interested parties are invited to submit comments concerning this issue.

Payments by a handler operating a partially regulated distributing plant. All current and consolidated orders provide a method for determining the payment obligations due to producers by handlers that operate plants which are not fully regulated under any Federal order. These unregulated handlers are not required under the scope of Federal milk order regulation to account to dairy farmers for their milk at classified prices or in returning a minimum uniform price to producers who have supplied the handler with milk. However, such handlers may sell fluid milk on routes in a regulated area in competition with handlers who are fully regulated.

Therefore, the regulatory plan of Federal milk orders needs to provide a minimum degree of regulation to all handlers who enjoy routes sales of fluid milk in a regulated marketing area. This is necessary so that classified pricing and pooling provisions of an order can be maintained. It is also necessary so that orderly marketing conditions can be assured with respect to handlers being charged the classified value under an order for the milk they purchase from dairy farmers. Without this provision, milk prices in an order would not be uniform among handlers competing for sales in the marketing area, a milk pricing requirement of the AMAA. There are 3 regulatory options that are available at the option of the partially regulated handler.

It is recognized under current orders that the purchase of Class I milk by a partially regulated handler of milk that is priced under a Federal order in an amount equal to, or in excess of, quantities sold by partially regulated handlers in the marketing area ensures that price equality is maintained between these entities. In these circumstances, a partially regulated handler will not be required to make payments to the producer-settlement fund so that the use-value of milk has been equalized between fully regulated and partially regulated handlers.

For those instances in which a partially regulated handler purchases no milk from fully regulated handlers, or where purchases are less than the quantity of route disposition in the marketing area by the partially regulated handler, a payment may be made by the partially regulated handler into the producer-settlement fund of the regulated market at a rate equal to the difference between the Class I price and the uniform price of the regulated market.

Many current orders also allow the operator of a partially regulated plant to demonstrate that the payment for its total supply of milk received from dairy farmers was in an amount equal to the amount which the partially regulated plant would have been required to pay if the plant were fully regulated. This amount may be paid entirely to the dairy farmers that supplied the handlers, or in part to those dairy farmers with the balance paid into the producer-settlement fund of the regulated market. This should be adopted in all orders.

All of the current orders also provide, under certain circumstances, for payment options by partially regulated handlers relating to reconstituted milk. All of the payment options available to a partially regulated handler are retained under the consolidated orders. This provision is now found in § 1000.76 of the General Provisions.

Adjustment of accounts. All current orders provide for the market administrator to adjust, based on verification of a handler's reports, books, records, or accounts, any amount due to or from the market administrator, or to a producer or a cooperative association. This provision continues to be included in the consolidated orders. The provision requires the market administrator to provide prompt notification to a handler of any amount so due and requires payment adjustment to be made on or before the next date for making payments as set forth in the provisions under which the error(s) occurred.

Charges on overdue accounts. All current orders provide for an additional charge to handlers who fail to make required payments to the producer-settlement fund when due. Such payments include payments to the producer-settlement fund, payments to producers and cooperative associations, payments by a partially regulated distributing plant, assessments for order administration, and marketing service and certain other payment obligations in orders with specialized provisions such as transportation credits. This should continue to be provided for in the consolidated orders.

In order to discourage late payments, it is proposed that a 1.0 percent charge per month be incorporated in the consolidated orders. This rate represents the mid-point in the range of charges by all orders presently. Overdue charges shall begin the day following the date an obligation was due. Any remaining amount due will be increased at the rate of 1.0 percent on the corresponding day of each month until the obligation is paid in full.

As proposed, all overdue charges would accrue to the administrative assessment fund. The late-payment charge is to be a penalty that is meant to induce compliance with the payment terms of the order. If late-payment charges for monies due on producer milk were to accrue to the balance owed to either producers, cooperatives or producers/cooperatives via the producer-settlement fund, it could result in such producers and cooperatives being less concerned whether they are paid on time, thus being counterproductive to the purpose of late payment provisions. Under the provision recommended, cooperatives and producers would not be placed in a position where they would prefer to be paid several days late so that they would receive the late-payment charges or increase the level of producer prices due to late payment fee accrual to the producer-settlement fund. This is of particular concern in markets with a single dominant cooperative. Additionally, by having late-payment fees accrue to the administrative fund, monies are made available to enforce late-payment provisions that would otherwise have to be generated through handlers' administrative assessments.

Assessment for Order Administration

The AMAA provides that the cost of order administration shall be financed by an assessment on handlers. All current orders provide for proportionate per hundredweight assessments of varying rates. As proposed, a maximum rate of 5 cents per hundredweight is

provided. The assessment would apply to all of a handler's receipts pooled under the order.

Deduction for Marketing Services

As in most current orders, the consolidated orders should provide for the furnishing of marketing services to producers for whom cooperative associations do not perform services. Such services should include providing market information and establishing or verifying weights, samples and tests of milk received from such producers. In accordance with the Act, a marketing services provision must benefit all nonmember producers under the order. They are not uniform in the consolidated orders.

The market administrator may contract with a qualified agent including a cooperative association to provide such services. The cost of such services should be borne by the producers for whom the services are provided. Accordingly, it is proposed that each handler be required to deduct a maximum of 7 cents per hundredweight from amounts due each producer for whom a cooperative association is not providing such services. All amounts deducted should be paid to the market administrator not later than the due date for payments to the producer-settlement fund.

6a. Northeast Region

The Northeast Marketing Area

The recommended consolidated Northeast order differs significantly from other consolidated orders. In addition to merging three existing Federal milk orders, the proposed Northeast order also recommends expansion in the western and northern regions of New York state, and all currently unregulated areas of the New England states (except Maine).

While the current New England (Order 1) and Middle Atlantic (Order 4) order have similar pricing provisions for adjusting producer blend prices in a manner identical to how plant prices are charged, the current New York-New Jersey (Order 2) order employs a "farm-point" pricing method. This decision recommends that the pricing of milk should employ a plant-point pricing methodology in the consolidated Northeast order. This method is used in every other current marketing area and in every recommended consolidated marketing area. This represents a considerable change in how milk will be priced for those handlers and producers who currently are priced under the provisions of the New York-New Jersey order.

In addition to the different pricing provisions of the three existing orders, other important differences and related provisions need to be addressed in recommending a complete Northeast regional order that will accomplish the goals of the AMAA. These include what is commonly referred to in the New York-New Jersey order as the "pass through" provision, the need for providing marketwide service payments in the form of cooperative service payments and balancing payments that currently exist in the New York-New Jersey order and do not exist in either the current New England or Middle Atlantic orders. Additionally, the three current northeast orders also provide for seasonal adjustments to the Class III and IIIA price, which may no longer be necessary in light of the replacement being recommended for the BFP.

It is fair to observe that the current order most affected by the recommended consolidation is the New York-New Jersey order. In addition to the differences already described, certain terms and provisions of the recommended Northeast order are also different in how they are described and presented but are nevertheless consistent with existing provisions that accomplish the goals of the AMAA. This is less of an issue for those entities that are accustomed to the terminology of provisions used in the New England and Middle Atlantic orders. The following presents a discussion of the recommended order provisions and issues that are unique to the consolidated Northeast order.

Plant

The plant definition for the proposed consolidated Northeast order should differ from that of the other consolidated orders by allowing stationary storage tanks to be used as reload points. This exception to the plant definition is warranted for the consolidated Northeast order due to certain unique conditions that affect the ability of producers to assemble milk in an efficient manner and subsequently transport it to a plant that actually processes milk into finished dairy products, including fluid milk products. This exception would not consider the reload point or facility as a point from which to price producer milk. Rather, milk once assembled would be shipped to a processing plant where it would be priced.

A portion of the Northeast milk supply is derived from some 200 small dairy farms located in Maine. Because much of this state is serviced by secondary and rural winding roads, the current New England order has

provided for reload points as a workable solution to the inherent hauling difficulties in transporting relatively small loads of milk from the countryside to reload points and facilities with stationary storage tanks that do not serve as a pricing point. This should continue to be provided for in the consolidated Northeast order. Not to provide this accommodation would adversely affect a substantial number of small producers and the milk haulers that service them.

Pool Plant

The *pool distributing* and *pool supply plant* definitions of the proposed consolidated Northeast order should use the standard order language format used in other orders, combined with performance standards that are adapted to marketing conditions in the Northeast.

The proposed pool distributing plant definition specifies that a pool distributing plant must have 25 percent or more of its total physical receipts of bulk fluid milk distributed as route disposition and that route disposition within the marketing area be at least 25 percent. The 25 percent level of total receipts distributed on routes is a reasonably high enough level to establish a distributing plant's association with the marketing area. The in-area route distribution performance requirement of 25 percent is recommended for two reasons. First, as one of the intents of Federal milk order reform was to adopt liberal pooling standards, a 25 percent level provides a level of association with the market that is liberal yet sufficiently high enough to assure pooling standards that are performance oriented. Second, it tends to minimize changing the regulatory status of handlers from their current regulatory status by the Federal order program through the consolidation of existing orders. This also seems a reasonable standard in light of individual state regulatory plans currently in place in Maine, Pennsylvania, and Virginia are applicable.

As already discussed, the recommended consolidated Northeast order and other nearby consolidated marketing orders do not recommend expansion to include currently unregulated areas. This includes areas in the states of Pennsylvania, Virginia, and the entire state of Maine. Some distributing plants in these areas are not currently regulated, or are only partially regulated to the extent they enjoy Class I sales in regulated areas. A 25 percent in-area route distribution level will serve to ensure or minimize any change

in their current regulatory status under the Federal program that result from consolidation of the three northeast marketing areas into a single new order.

Unit pooling, wherein two or more plants operated by the same handler located in the marketing area can qualify for pooling as a unit by meeting the total and in-area route distribution requirements of a pool distributing plant, is recommended for inclusion in the consolidated Northeast order. Providing for unit pooling provides a degree of regulatory flexibility for handlers by recognizing specialization of plant operations.

Due primarily to positions offered by many of the major Northeast dairy cooperatives and their recommendations on appropriate pool supply plant performance requirements, the consolidated Northeast order supply plant performance requirements initially should be set to require that in the months of August and December, at least 10 percent of the total quantity of bulk milk that is physically received at a supply plant be shipped to distributing plant. For the months of September through November, such shipments by pool supply plants should be at least 20 percent. To the extent that a supply plant has met these performance requirements, no performance requirement is recommended for the months of January through July. However, a supply plant that has not met these performance requirements will need to meet a 10 percent performance requirement in each of the months of January through July in order to qualify as a pool supply plant.

While this decision has recommended providing for pool reserve supply plants, it is not recommended for inclusion in the provisions for the consolidated Northeast order. However, providing for a system of supply plants is recommended for the consolidated Northeast order and this provision is sufficiently self-explanatory in the proposed order language.

Producer-Handler

The producer-handler definition for the consolidated Northeast order should conform to the limitations on receipts at its plant or acquiring for route disposition no more than 150,000 pounds of fluid milk products from handlers fully regulated under any Federal order. This should cause no change in the regulatory status of any known producer-handler currently in operation in the proposed consolidated Northeast order region.

Producer

The producer definition of the proposed consolidated Northeast order should be defined as described in the proposed order language for the order. This definition describes those dairy farmers who are properly associated with the Northeast marketing area and who should share in the benefits that accrue from the marketwide pooling of milk in this area.

The months specified in the producer definition for defining when a dairy farmer would not be considered a producer under the order are so indicated because they tend to accurately reflect the seasonality of supply for meeting the market demands for milk during the "short" season in the proposed Northeast marketing area. Accordingly, the producer definition should not include dairy farmers who's milk during any month of December through June is received as producer milk at a pool plant or by a cooperative association handler if the operator of the pool plant or the cooperative association caused the milk from such producer's farm to be delivered to any plant as other than producer milk as defined in the producer milk provision of the proposed Northeast order, or any other Federal milk order during the same month, in either of the two preceding months, or during any of the months of July through November.

Similarly a dairy farmer would not be considered a producer under the order, for any month of July through November, any dairy farmer whose milk is received as producer milk at a pool plant or by a cooperative association handler if the pool plant operator or the cooperative association caused the dairy farmer's milk to be delivered to any plant as other than producer milk, as defined in this proposed order, or in any other Federal milk order during the same month.

Producer Milk

The producer milk definition of the consolidated Northeast order should follow the general structure and format of other consolidated orders. It differs from other consolidated orders in that it requires cooperative handlers to organize reports of producer receipts that are outside of the states included in the marketing area, or that are outside of the states of Maine or West Virginia, into state units with each unit separately reporting receipts.

As previously discussed, not all consolidated orders set diversion limits for producer milk. For the proposed Northeast order, no diversion limits are established as they are, for example in

the proposed Florida order. However, diversions are limited in functional terms. The maximum quantity of milk that a pool plant would be able to divert and still maintain pool plant status would be 100 percent minus the applicable shipping standard.

Component Pricing

The consolidated Northeast order should employ a component pricing plan in the classified pricing of milk under the order as previously discussed in the BFP section of this recommended decision. This recommendation is consistent with positions taken and proposals offered by major cooperative groups in the Northeast who supply a large percentage of the milk needs of the market. This also conforms with the recommendations discussed earlier in this decision on replacing the BFP.

Farm-Point vs. Plant Point Pricing

At issue in the suggested merging of the three northeast marketing areas is the use of two distinct pricing methods. The Middle Atlantic and New England marketing area employ a system of plant-point pricing. This pricing method is also employed in every other marketing area in the Federal order system. Only the New York-New Jersey marketing area uses what is called "farm-point" pricing. This decision recommends the adoption of plant point pricing as the pricing method for the consolidated Northeast order.

Plant-point pricing of milk that is pooled under an order prices milk f.o.b. the plant of first receipt. The cost of hauling from the farm to the plant is the responsibility of the producer. When the receiving handler is also the hauler, orders permit the handlers in making payments to each producer to deduct hauling costs up to the full amount authorized in writing by the producer.

As originally employed in the New York-New Jersey order (Order 2), farm-point pricing establishes the price for milk by the zone (distance from market computed the nearer of the basing points) of the township in which a producer's milkhouse is located. While termed "farm-point" farms are grouped by their township location. However, this is the nearest practicable proxy for farm location. In functional terms, when a handler picks up milk at a producer's farm, the handler takes title of the milk at the time and point of pickup. Accordingly, there are no adjustments in payments to producers to cover any part of the cost of pickup or hauling in moving milk to the handler's plant. Farm-point pricing fundamentally shifts the cost of transporting milk from the producer to the handler. Farm-point

pricing has been in effect in Order 2 since 1961. While the fundamental concept of farm-point pricing has been retained with respect to its overall structure of mileage zones, other order provisions were adopted subsequent to its establishment and modified over time so that farm-point pricing could remain viable.

In the decision that established farm-point pricing (25 FR 8610, Sept. 7, 1960), prevailing marketing conditions served to warrant this type of pricing system. At that time, the emergence of bulk-tank milk began to take on a degree of prominence in the milk supply of Order 2. Prior to the adoption of farm-point pricing (1959), about 8 percent of the producers had bulk tanks, accounting for at least 14 percent of the volume of milk associated with the market. About 92 percent of producers delivered their milk at their own expense directly to plants in 40 quart cans. Most of the milk can-delivered was from farms within a radius of not more than 15 miles from the plant. The milk of producers who had converted to bulk tanks, in some instances, had been hauled more than 200 miles from farm to city plants, but the majority of bulk tank milk was moved much shorter distances to country receiving plants. The decision cited that in October, 1959, milk was received from 49,719 producers at 691 plants.

When milk was delivered in cans to a handler's plant, the plant was the location of where milk was weighed, sampled for butterfat and quality, and where cans were washed. It was at the plant that milk was accepted or rejected. It was the place where milk was cooled and co-mingled with other individual producer's milk. More importantly, it was the place where control of the milk passed from producer to the plant operator or moved by the plant to other plants for fluid or manufacturing uses. Minimum prices required by the order to be paid by handlers were adjusted for the location of the plant at which milk was received from dairy farmers.

Bulk tank milk brought a set of new factors. When milk is transferred from a producer's bulk tank to the hauler, the point of transfer is also the point where several functions are performed. Milk in a producer's bulk tank has already been cooled, and therefore not subject to the early delivery deadlines. The weight of milk is determined at the bulk tank and is also the place where samples are taken for butterfat and quality. It is also here that the individual producer's milk is accepted or rejected and loses its identity by being co-mingled with other milk.

Numerous problems arose in regulating the handling of bulk tank milk in an order where pooling depended upon direct delivery from the farm to a pool plant and under which minimum class prices and the uniform prices to be paid to producers was reflective of the location of the plant where delivery was made:

1. Administrative problems associated with bulk tank handling arose, particularly where and when milk was regarded to have been received. Bulk tank milk provided the opportunity to deliver milk to different plants, some pool and some nonpool. Where a given tank load of milk was unloaded if it went to two or more plants of the same or different handlers on the same day was difficult to determine.

2. The incentive arose (because of the administrative difficulty of determining when and where milk was received) for handlers to behave in a way that would result in the maximum exclusion of milk from the pool for fluid use outside the marketing area.

3. The incentive arose for the maximum inclusion in the pool of milk in fluid and manufacturing uses.

4. The incentive and opportunity arose for handlers to select one of several plants for receipt of bulk tank milk, with or without manipulation of hauling charges. This distorted and impinged upon the effectiveness of the minimum price provisions of the order, especially in the case of relatively long hauls of bulk tank milk.

The 1961 decision that established farm-point pricing provided 8 scenarios that demonstrated how handlers behaved so as to minimize their pricing obligations to producers. Most of the scenarios arose from the inability to determine when milk was received at a plant. In order to mitigate such circumstances, several things were done. Foremost, was the establishment of farm-point pricing on the basis of bulk tank units and the designation of each bulk tank unit as either a pool or nonpool unit and defining the circumstances under which designations could be changed.

The pricing of milk at the farm eliminated the incentive for handlers to attempt to make it appear that the plant of receipt was other than the plant where milk is actually received and handled. It was made crystal clear that delivery and receipt of bulk milk takes place at the farm. Once acquired by the handler, the plant or plants to which the milk may be delivered depended on the decision of the handler, not the producer. Under these circumstances, where the milk is actually used is not a factor to be reflected in the minimum

producer price. The operator of the bulk tank unit was defined as the handler and the point of receipt of milk. This entity was responsible for establishing the unit, and the entity held the responsibility for reporting, accounting, pooling and paying producers. Additionally, the decision concluded that the price at which the farm bulk tank is accounted for to the pool should be the minimum class price adjusted for location of the farm, that payments by handlers directly to producers be adjusted to reflect all location differentials based on where farms are located and where bulk tank milk is received.

A proposal that would have allowed a tank truck service charge authorized by the producer but not in excess of 20 cents per hundredweight (cwt.), and payments to cooperatives which serve as handlers operating a bulk tank unit should be at the price reflecting transportation and (the then existing) direct delivery differential applicable at the handler's plant where milk is delivered by the cooperative was not incorporated into the order. At that time, it was found that plant hauling charges averaged nearly 20 cents per cwt. This was offered as rationale for a negotiable 20 cent per cwt. charge by handlers for hauling. Arguments notwithstanding, the underlying concepts embodied in farm-point pricing caused the Department to not allow for any hauling deduction by handlers.

Shortly after the implementation of farm-point pricing, the need to amend the order to keep farm-point pricing viable arose. The first occurrence was in 1963. In the 1963 decision (28 FR 11956, Oct. 31, 1963), it was noted that there had been significant changes in marketing conditions that arose from establishing farm-point pricing in 1961. These included the reduction in premiums to bulk tank producers in general; the reluctance of proprietary handlers to receive bulk tank milk from individual producers in order to avoid the hauling costs; the differences in pricing can and bulk tank milk; and a slowdown in the trend of conversion from can milk to bulk tank milk. The 1963 decision, in acknowledging changing marketing conditions, incorporated into the Order, an authorized 10-cent per cwt. charge for hauling, provided that producers authorize this maximum level in writing.

In the 1963 decision the Secretary found that allowing for a limited authorized service charge for hauling bulk tank milk at a maximum rate of 10 cents per cwt. was sufficient. This was

largely based on the fact that handlers were not then charging for bulk tank pickup and hauling, but rather were paying premiums for bulk tank milk. Additionally, can milk direct delivered by producers to plants was still very much the norm. While bulk tank milk was growing, it had not yet accounted for a majority of milk pooled on the order. The 10-cent negotiable hauling charge was found to provide the needed flexibility for handlers to receive bulk tank milk from individual producers.

This decision raised, for the first time with respect to farm-point pricing, the maintenance of orderly conditions and the uniform pricing to handlers on all milk priced and pooled under the order. Because bulk tank milk is priced by township zone (the best proxy for a farm's location) all farms in any particular township have the same value assigned to their milk. However, the decision found it necessary to reflect appropriate uniform pricing of bulk tank milk because it has differing value dependent on the accessibility and relative location of individual farms within the township. With this finding, it was determined that responsibility for hauling to the township pricing point should be borne by the producer with appropriate safeguards to protect the producer. Therefore, a maximum negotiable hauling charge from handlers of 10 cents per cwt. was brought under the order.

By 1970, marketing conditions in the New York-New Jersey market had changed to the point where handlers were authorized to receive a full 10-cent hauling credit for each cwt. of bulk tank milk which was disposed of for manufacturing uses. Additionally, the negotiable 10-cent hauling charge to producers for a handler's cost offset established by the 1963 decision was retained. However, the 10-cent negotiable limit was limited to manufacturing milk. Can milk at this time represented about 25 percent of the total amount of milk pooled in Order 2, with the balance being bulk tank milk.

Proponents supporting this change to the order claimed, and the decision affirmed, that the manufacturing price for milk in Order 2 was not properly aligned with manufacturing class prices in adjacent Federal orders. In this decision (35 FR 15927, Oct. 9, 1970) the Secretary found that to the extent that Order 2 handlers had borne the transportation costs associated with the pickup and movement of bulk tank milk used in manufacturing from the farm to the plant, Order 2 handler costs exceeded the price which handlers in adjacent order markets were required to pay for milk used in manufacturing. By

adopting this transportation credit for handlers, there was no need to adopt other proposals that would have lowered the manufacturing price for milk under the other northeastern orders or lower the Class I price for milk in Order 2 as had been proposed and denied.

By 1977, some 16 years since the adoption of farm-point pricing, marketing conditions had changed again and the issue of providing for more equitable competition both within the Order 2 market and between other orders took on primary importance. By this point in time, can milk was about 3 percent of the market, with the balance represented by bulk tank milk, the near inverse of the marketing conditions prevailing in 1961. The transportation credit that had been established for handlers in the 1970 decision for manufacturing milk was now extended to *all milk* received by handlers. The transportation credit was increased to 15 cents per cwt., plus an additional 15-cent maximum negotiable credit above the "automatic" 15 cents because total average transportation costs was found to be about 30 cents per cwt. For reasons nearly identical to the 1963 and 1970 decisions, "formalizing" the negotiable hauling charge was not adopted because of the need of flexibility in accounting for milk movements from the farm to the township pricing point (42 FR 41582, Aug. 17, 1977). In that decision the Secretary also raised the direct delivery differential from 5 cents to 15 cents per cwt. in the 1-70 mile zone for can milk delivered by farmers to plants within this zone, changed the transportation adjustment rate from 1.2 cents per cwt. for each 10 miles to 1.5 cents per cwt. for each 10-mile zone beyond the 201-210 zone, and 1.8 cents per cwt. for each 10-mile zone within the 201-210 mile zone.

Cooperatives were of the strong opinion that the cost of milk assembly and transportation are the marketing costs of the handler and not by producers. However, they also indicated that changes are warranted in the order because of the failure of neighboring markets to adopt farm-point pricing.

Comparative examples of handler price inequities with respect to their cost of milk was amply demonstrated for both intra and inter market situations. With respect to inappropriate price alignment between orders, the competitive relationships between Order 2 and Order 4 (then known as the Delaware Valley Order) were closely examined. On intra-order movements of milk, it was shown that Class I handlers in New York City had a significantly

lower procurement cost for direct-ship over bulk tank milk because bulk tank milk from "distant" supply plants had higher transfer and over-the-road hauling costs. Supply plant milk at the city represented about 80 percent of milk receipts at city plants. The inter-market situation demonstrated that handlers in Philadelphia accounted for milk at prices lower than New York handlers. Order 4 handlers were in a position to establish lower resale prices for fluid milk than their competitors in the New York market because the burden of increased hauling costs fell largely on Order 2 handlers. As in 1970, other proposals were denied in light of adopting the 15-cent hauling credit for handlers. These other proposals included lowering Class I and the manufacturing price for milk in the order by 15 cents per cwt.

By 1981, bulk tank milk accounted for nearly the entire milk supply pooled on Order 2—about 99.6 percent. As the result of a hearing held in June 1980, in the final decision (FR 46 33008, June 25, 1981) the Secretary again amended the transportation credit provisions of the order. The 15 cents per cwt credit for handlers was retained, however, the 15-cent negotiable transportation service charge was modified to allow handlers to negotiate with producers for any farm-to-first plant hauling cost in excess of the 15-cent transportation credit, plus "the amount that the class use value of the milk at the location of the plant of first receipt was in excess of its class use value at the location where milk was received in the bulk tank unit from which the milk was transferred." According to the 1981 decision, this amendment would adjust hauling allowances for handlers to more closely relate the location value of milk to the costs incurred in transporting milk from farms and country plants to distributing plants in the major consuming markets of the market. Additionally, the decision indicated that this change was necessary to reflect current marketing conditions and permit a more equitable competitive situation for regulated handlers, both on an intra market and inter market basis. The decision also applied a 15-cent direct delivery differential for bulk tank milk from New York City out to the 61–70 mile price zone, on the basis that direct delivery differential is applicable to milk received in cans at a plant in the 1–70 mile zone.

In the 1981 decision the Secretary found that the majority of milk moved to distributing plants in 1979 from the 1–70 mile zone moved directly from farms, accounting for about 58 percent of plants in this zone with 48 percent being reloaded. Moreover, the decision

found that Order 2 plants located in northern New Jersey received direct shipped milk as did handlers located in Order 4. Thus, inter market price alignment needed to be structured primarily on the basis of handlers obtaining direct shipped milk.

A federation of cooperative associations representing Order 4 producers proposed that Order 2 be amended to return to plant-point pricing, with the direct delivery differential being reduced to 10 cents per cwt, and that the Class I differential at the base zone of Order 2 be increased from the \$2.25 level then in effect, to \$2.40. This federation of cooperatives believed that this "package" of order modifications would provide for proper price alignment between Order 2 and Order 4. While the decision did apply different transportation rates at a rate of 1.8 cents per cwt. outside the base zone of the Order (201–210) and a rate of 2.2 cents per cwt. inside the base zone, it did not provide for a return to plant-point pricing.

While the decision did not adopt plant point pricing, the decision does acknowledge that the amendments adopted tended to establish plant pricing with respect to the classified prices to handlers. However, farm-point pricing was retained with respect to uniform prices to producers. With this being the case, the basic substantive difference between the amendments and plant pricing is the impact on the movement of milk to higher-priced zones for manufacturing use. Under plant pricing, the minimum uniform price payable to producers applies at the location of the plant of first receipt and handlers receive a credit from the producer settlement fund at such uniform price. The decision also concluded that plant-point pricing for producers would provide a greater incentive to haul direct-shipped milk to city plants for manufacturing uses, since there would be a credit from the pool for the full amount that the uniform price transportation differential at the city plant exceeds the transportation differential for the zone of the bulk tank unit. Adopting plant-point pricing for producers would have had the effect of encouraging milk to move long distances to city plants for manufacturing uses when transportation savings could be realized if such milk stayed nearer to manufacturing plants generally located in the milkshed.

Farm-point pricing has undergone many evolutionary changes from its inception in 1961. The original rationale for farm-point pricing, free hauling and the administrative difficulty of determining when milk from bulk tank

units was received seems far removed from present-day marketing conditions and the rationale for continuing it. There were a number of years that hearings were necessary to first recognize that the burden of transportation costs rested with handlers. This resulted in handlers being able to successfully argue that with this burden, it becomes much more difficult for the order to establish and maintain uniform prices to handlers as required by § 608(5)(c) of the AMAA. This is evidenced by the nature of the decisions of 1963, 1970, 1977, and 1981. Much "repair" to other order provisions was also needed to retain farm-point pricing. Accordingly, farm-point pricing has outlived its intended purpose and the Secretary proposes that it should not be retained in a consolidated Northeast order.

The Need for a Producer-Price Mechanism

As discussed above, farm-point pricing for producers did provide some rational pricing incentives to promote efficiency within the Order 2 marketing area. This can reasonably be summed up by concluding that farm-point pricing would not provide, as plant-point pricing would, incentives to haul direct-shipped milk to city plants for manufacturing uses, since there would not be a credit from the pool for the full amount that a uniform price transportation differential at the city plant exceeds the transportation differential for the zone of the bulk tank unit. Adopting plant pricing would have had the effect of encouraging milk to move long distances to city plants for manufacturing uses when transportation savings could be realized if such milk stayed nearer to manufacturing plants generally located in the milkshed.

In an effort to address the dairy industry structures that have evolved over the past four decades in the three current northeast marketing areas, efforts were undertaken by a major group of dairy farmer cooperatives in the northeast to address what the pricing implications are to producers and handlers as the region moves to a unified plant-point pricing method. This has resulted in a proposal by the Association of Dairy Cooperatives in the Northeast (ADCNE) that include St. Albans Cooperative Creamery, Inc., Land O'Lakes, Upstate Farms Cooperative, Inc., Agri-Mark, Inc., Milk Marketing Inc., Dairylea Cooperative Inc., and Maryland & Virginia Milk Producers Cooperative Association Inc. These dairy farmer cooperatives account for well over half of the milk that would be pooled and priced under the

proposed consolidated Northeast order. Their proposal calls for establishing a producer differential structure that would "overlay" the Class I differential structure that would apply in the consolidated Northeast order.

The structure proposed is a county-based plant-point price structure, providing for 14 zones that accommodate the need to reflect existing and longstanding competitive price relationships among plants, while integrating the farm and plant point pricing systems currently used in Order 1, 2, and 4 and with currently state-regulated areas that fall outside of the proposed marketing area. Further, the ADCNE proposed prices at the major cities in the Northeast, including Boston, New York City, Philadelphia, Baltimore, and Washington, D.C. to have specific Class I differential levels that are somewhat different from those recommended in the Option 1A Class I price surface. For example, this decision recommends a New York City Class I differential of \$3.15, while ADCNE proposes \$3.20. In general, the ADCNE proposal assumes that the Class I differential structure that will be adopted is Option 1A, is the Class I pricing option they strongly support, and is also the Class I pricing option overwhelmingly supported in public comments received from interested parties from the northeast.

With respect to a producer differential surface, the ADCNE proposed that a debit of 5 cents per cwt. be made to the blend price applicable at non-distributing plants in certain zones. The need for the debit, according to the ADCNE proposal, is to make deliveries to distributing plants somewhat more attractive to producers, while decreasing the amount by which manufacturing plants draw on the marketwide pool for transportation values, offering also that such a debit is economically justified and authorized by the AMAA. According to ADCNE, it is distributing plants that provide the revenue, in the form of Class I values which form the blend price paid to producers. Deliveries to manufacturing plants do not contribute to increasing the value to the marketwide pool. The debit, according to ADCNE, is a reflection in part of the Order 2 system, which has priced some 50 percent of the milk in the northeast region, and which does not provide location-based transportation payments for movements from farms to manufacturing plants. The ADCNE proposal provides that deliveries to Class I plants are rewarded under this system with an additional 5-cent payment from the pool for the

marketwide benefit conferred a distributing plant's utilization.

For the Western New York State order area of the order, ADCNE also proposed a broad area in which a producer differential of \$2.40 per cwt. to producers would be payable on deliveries of producer milk at all plant locations in this area. This portion of the price surface proposed by ADCNE purports to be reflective of the major historical movements of milk from east to west in the region which returned the eastern farm point price to dairy farmers under Order 2's farm-point price system, and that the Western New York State order has not had any location differentials, thereby establishing a "flat" price surface in the area. If those plants, for producer pricing purposes, were zoned lower in value reflecting the westerly and northerly distance from New York City or Philadelphia, ADCNE is of the view that the ability of both distributing and supply plants of plants to attract an adequate supply of milk could be in jeopardy. Furthermore, the expectation that Class I utilization of the proposed Mideast order will be nearly 10 percent higher than the Class I utilization in the Northeast order was also offered in support of ADCNE-proposed producer differential level in this area.

The ADCNE proposal also recommends producer differential levels in areas that they believed should be included in either the consolidated Northeast order or the Mideast order through expansion that this proposed rule does include for consideration. Additionally, the ADCNE proposal also addresses producer differential levels at other locations outside of the Northeast region.

Additional supporting and amplifying comments were also provided by Dairyalea. These comments supported the major themes offered in the ADCNE proposal for a producer differential overlay to Class I differential levels. Dairyalea states that moving directly to a plant-point pricing method would accentuate "existing inequities and market dysfunctions." Dairyalea further commented that a plant-point differential schedule would maintain current inter-plant price differences in the current New England and Middle Atlantic orders, but would worsen them for New York manufacturing plants, many of which are cooperatively owned. Their view of the ADCNE pricing proposal is that it maintains economic incentives for milk to move to Class I distributing plants, would provide for more balanced procurement equity among competing manufacturing plants, maintain equitable producer

pricing when milk is marketed by transporting it from a higher priced zone to a lower priced zone, and provides a structure that allows for adequate blend price levels in all areas of the Northeast milkshed.

Dairyalea further comments that in addressing adopting plant-point pricing, existing "near-in" manufacturing plants (plants located in a relatively high differential location) would enjoy a procurement advantage relative to their competitors that are located in a lower priced location. Dairyalea recommends narrowing the price difference between manufacturing plants that compete for producer milk and/or finished dairy product sales. To do this, Dairyalea supports lowering producer differentials for manufacturing plants that are located in high-valued locations and increasing those differentials at manufacturing plants in areas that have lower location values. Dairyalea advocates the ADCNE proposal for a producer differential that is 5-cents lower than those of Class I plants when such plants are located in the same pricing zones. Dairyalea's view of this design results in maintaining, or slightly increasing, producer differentials applicable at Class I plants and reducing those applicable at "near-in" manufacturing plants. At the same time this would provide for increasing producer differentials at manufacturing plants in central, western, and northern New York. According to Dairyalea, this producer pricing surface would present a more equitable marketing environment than strict plant-point pricing currently employed in Orders 1 and 4, while at the same time not threatening the viability of manufacturing plants in those areas of a consolidated Northeast marketing area.

A major theme of Dairyalea is its view that Federal milk orders and their provisions should foster an environment under which manufacturing plants are provided equal cost and procurement ability, and not to disfavor such manufacturing plants located in high milk production areas where Class I differentials are lower. This view, as expressed, seems a departure from the intent of Class I differentials serving to attract an adequate supply of milk at locations to satisfy fluid demands. Dairyalea also states that the final rule of 1991 that realigned intra-order prices in Order 2 resulted in harm to producers in northern and western New York. While it is not appropriate to specifically revisit this issue and decision here, official notice is taken of the final decision (55 FR 50934, December 11, 1990) that realigned Class

I differentials in the three existing northeast marketing areas.

Comments supporting the ADCNE proposal for a producer pricing surface were also offered by Upstate Farms Cooperative, Inc. The Upstate Farms views served to reiterate the major themes developed in the ADCNE proposal.

Agri-Mark, a part of ADCNE, filed separate and dissenting views on the ADCNE proposal. Conceptually, Agri-Mark notes that plant and farm-point pricing are different, but notes further that the differences are not always unfavorable. Agri-Mark submits that under plant-point pricing, all producers shipping to the same plant receive the same minimum order blend price regardless of where their farm is located. Under farm-point pricing, farmers shipping to the same plant receive different prices under the order depending on where their farm is located. Farms closer to New York City, Agri-Mark notes, receive a higher price than farms farther from the city, even though their milk ends up in the same place.

As to the efficiency arguments touted to be derived from farm-point pricing, Agri-Mark notes that most manufacturing plants, especially cheese plants, were built in the northeast prior to the adoption of farm-point pricing and not in response to it. Rather, says Agri-Mark, these plants were built at their present locations because of their proximity to abundant milk supplies. The procurement problems for manufacturing plants that Order 2 entities alert us to, did not arise in New England manufacturing plants under plant-point pricing even though these plants were located as far north as possible within the milkshed for New England.

Simply put, Agri-Mark believes that rather than decreasing the differential between manufacturing plants and city distributing plants, an increase is justified. They are also of the opinion that manufacturing plants located far from higher-priced zones will maintain an advantage even with the adoption of strict plant-point pricing because this milk does not need to travel long distances to reach manufacturing plants. The ADCNE proposal would cause Agri-Mark producers to receive lower prices that competitive price relationships do not warrant.

The Agri-Mark view of Federal milk marketing orders differs substantially from the views expressed by DairyLea. Agri-Mark states that the role of Federal milk marketing orders is to treat all producers equitably relative to how their milk is used and not to weaken

price integrity by promoting or causing producers to compete for Class I sales. This is best accomplished, according to Agri-Mark, with appropriate pooling requirements and Class I differentials to satisfy the Class I demands of the market. Agri-Mark fears that if the regulatory pricing plan gives a distributing plant an advantage over a cooperative manufacturing/balancing plant in the same zone, that plant can use this advantage for itself instead of passing it along to farmers to offset transporting their milk to market. A 5-cent debit to the Class I differential schedule is, in the view of Agri-Mark, significant. If so set, Agri-Mark submits, pressure will come from distributing plants to see this 5-cent price difference grow.

Lastly, in their opposition to the ADCNE proposal, Agri-Mark notes that no manufacturing plant has been built in any city zone for decades, noting that the only significant plants in such areas for the northeast are older plants producing nonfat dry milk and butter and serve to balance the Class I needs of city markets, concluding that such plants are there for common sense and efficiency reasons. In support of this observation, Agri-Mark notes that existing Class I differentials have not been adjusted to more fully account for increases in hauling costs.

A recommendation on whether or not to adopt a producer pricing differential structure that differs from a Class I differential cannot be made in this proposed rule. The issue before the Department is to examine the impact of the change from farm-point to plant-point pricing on producers as part of recommending the adoption of plant-point pricing for the new consolidated order. The change to plant-point pricing will affect approximately one-half of the producers in the consolidated marketing area and is a significant departure from historical methods of distributing the revenue that accrues from classified pricing to producers. Plants will not experience significant change since plants currently regulated under Order 2 already account to the marketwide pool at the Class I location differential value. The issue then, tends to focus on how to pool and distribute the revenue as equitable as possible to producers.

There are significant differences between Option 1A and Option 1B that may result in price relationships never before experienced by either producers or handlers in the northeast. This, in and of itself, may cause both proponents for and against a producer price differential to reconsider their position in the need for and development of a producer price surface founded on the

pricing structure of Option 1A. Nevertheless, under either Option 1A or Option 1B, further analysis is needed in determining the need for adjusting producer blend prices by a method that differs from that currently applied to all orders, including the development of appropriate order language.

Competitive equity between manufacturing plants is already ensured by the classified prices applicable to handlers who operate such plants. In fact, this proposed rule suggests a uniform Class III and Class IV price be applicable for all locations. The more appropriate issue this proposal seems to address is that manufacturing plants are often cooperatively owned. All entities, including cooperatives in their capacity as handlers, account to the marketwide pool at the manufacturing price for milk received at their plants. The price paid to producers is the blend price for all milk pooled on the market and that was priced according to its use. Cooperatively owned manufacturing plants located in higher priced areas will pay a higher blend price to producers who deliver milk to that location provided they meet the performance requirements for being pooled thereby demonstrating the appropriate degree of association with the market. In this regard, it is worthy to note that not all manufacturing plants in the high-valued zones in the New York marketing area are pool plants. Blend prices are adjusted everywhere according to the location value of the plant. Adjusting producer blend prices on the basis of whether or not milk was delivered to a distributing plant or to a manufacturing plant seems to create a form of producer price discrimination that classified pricing and the mechanism of marketwide pooling and its related provisions attempt to mitigate. Such pooling provisions provide a degree of equity to producers in the form of a uniform blend price adjusted only for the location value on all milk pooled on the market. Classified pricing and marketwide pooling have served well to mitigate the price competition between producers seeking preferred higher-valued outlets for their milk, while at the same time ensuring handlers uniform prices, adjusted only for location, in the prices they pay for milk. This proposal, as currently developed, seems to take a step backward in that it may be inadvertently creating a degree of price competition between producers that classified pricing and marketwide pooling sought to minimize.

As DairyLea commented, the 1991 rule that realigned prices in the three current northeast orders may not have gone far